Maybank

Macro | FX Research & Strategy

Global

FX Monthly

2017, Issue 7: Still Taking Cue from US Inflation?

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What Has Changed This Month?

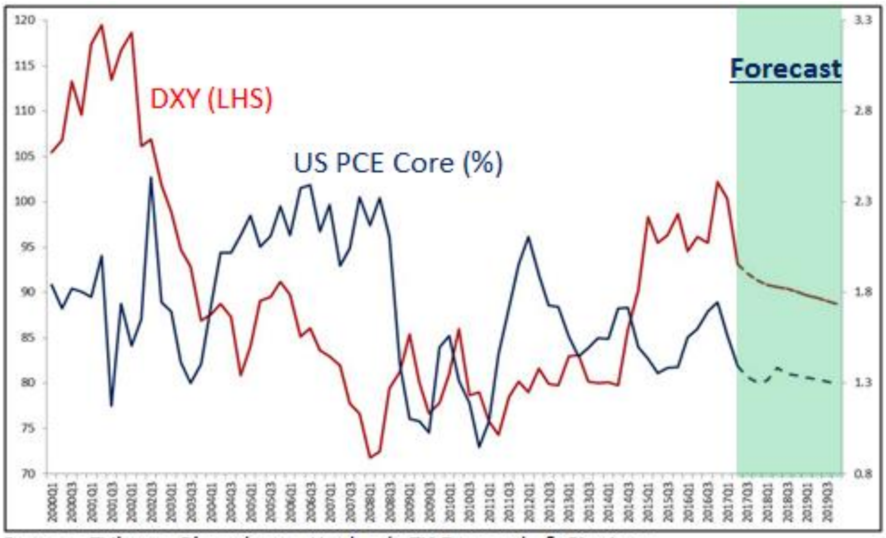
- We revised most of the currencies (except for KRW & NZD), stronger in our forecasts. The USD DXY forecast has been adjusted lower accordingly as a result of the combined changes above on the index.

Our Strategies

- US fiscal impulse is likely to be delayed into 2018. Inflationary pressures in US are now still not certain with recent data showing a bit of softness. Nonetheless, US activity seems to remain positive. The July meeting suggests that the Fed may be starting to waver in its determination to tighten monetary policy further this year with one more hike plus balance sheet reduction. **Our house view is for a 25bps rate hike, likely in Dec now and balance sheet reduction to start as early as Oct.**
- Global policy unwinding will take shape at differing pace. BoE could potentially move in the upcoming meetings in Aug or Nov; RBA is slightly behind the curve in tightening but concerns on household debt and slow pace of wage growth may keep the RBA on hold for this year; RBNZ is likely to remain on hold till Mar-2018 unless inflation overshoots to the upper band of RBNZ target range (which is not our view); ECB is not in a hurry to tighten as path of forecasted inflation is not expected to hit ECB's target within the next 10 quarters but we do not rule out slower pace of asset purchases; BoJ is stuck with its easy monetary policy bias as inflation remains subdued. BoJ needs to continue with its powerful easing and is likely to remain the laggard amongst its G7 peers. In terms of relative value plays on FX, we are broadly bullish on AUD, GBP, NZD and to some extent, EUR but bearish on JPY. **We maintain our view of EUR long vs. JPY, on the basis that ECB is likely to normalize policies ahead of BoJ.** Given recent market development, we calibrate our EUR forecast higher across the forecast horizon.
- Amongst AXJs, we remain positive on the MYR given the recent initiatives from BNM. We expect foreign investors' confidence to gradually return. We see scope for Ringgit to play catch up with regional peers and potentially extend its gains further towards 4.25, 4.20 levels (vs the USD) in June. Prefer to long the MYR, IDR, SGD against PHP, JPY.
- The delay in Fed's timeline of normalising monetary policies is likely to impact on asset allocation in ASEAN. UST yields are likely to remain soft resulting in widening of yield differentials in favor of ASEAN bonds. At the same time, the low interest rate environment for longer could spur a further re-weighting of equities and re-ignite foreign interest in ASEAN equities. Furthermore our view of global synchronised recovery story should further support inflows into ASEAN selectively.
- Our analysis examining the impact of an adjustment by the Fed to its balance sheet on ASEAN FX suggests that moves in ASEAN FX are likely to be muted. The failure of the Fed to act on reducing its balance sheet could see the SGD and THB outperforming the MYR and IDR. For PHP, we believe idiosyncratic risks present at the moment may outweigh benefits from delay in Fed's schedule of normalising its monetary policies.
- **Fundamentally, we could short PHPINR on diverging current account balances,** although if oil stabilises currencies of oil importers such as INR and KRW could weaken.

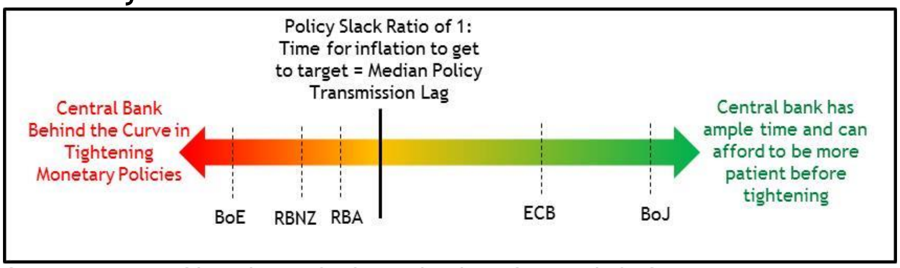
So What?

USD softness may persist for longer than expected, in the event US inflation remains subdued (deviates away from Fed's 2% inflation target). DXY Support around 88 – 90 Levels



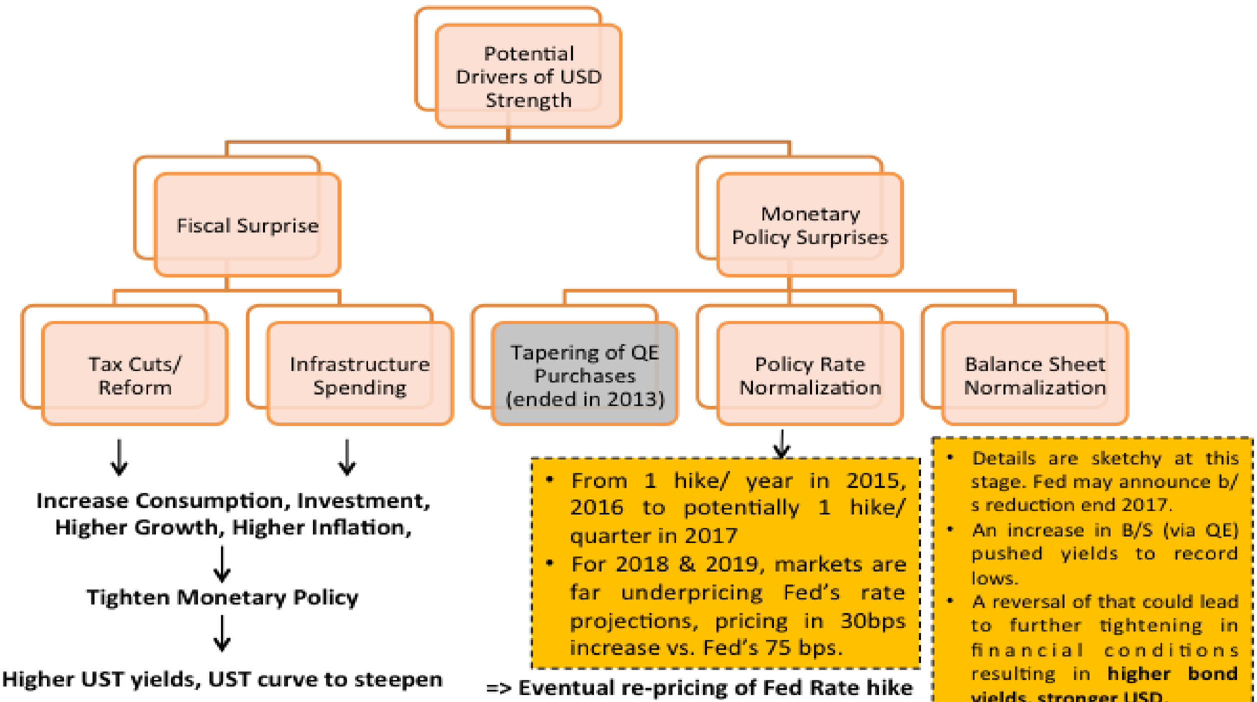
Source: EViews, Bloomberg, Maybank FX Research & Strategy

If inflation is the only variable in consideration, BoE and RBNZ are Likely to be the Next to Raise Rates



Source: Eviews, Bloomberg, CEIC, Maybank FX Research & Strategy

Where Can USD Strength Come From?



Source: Maybank FX Research

G7 Global Overview

USD: Inflation Softness Transitory or Sustained?

Forecast	3Q 2017	4Q 2017	1Q 2018	2Q 2018
USD Index	94.89 (98.09)	94.96 (97.70)	94.33 (97.05)	95.20 (97.97)

Previous Forecast in Parenthesis

- **Motivation for the FX View:** We have turned slightly bearish on the USD over the next 3-6 months. Nonetheless, we expect at least one more rate hike in 2017, more likely in Dec now followed by the start of the balance sheet reduction in 4Q 2017 (possibly as early as Oct 2017). We do caution that additional repricing of a surprise balance sheet reduction over the course of the year could continue to see UST yields higher in particular Treasuries 2y and below, and see USD strength (buy the rumor) in the lead-up to FOMC meetings. The DXY forecasts saw downward revisions due to our upward revisions to the key G7 currencies such as the EUR and JPY. ***However, we expect USD to rebound late this year and early next year with occasional swings within a tight range in the interim by around 5% or so. At current levels, long USD positions vis-à-vis G7 currencies, in particular the euro is beginning to look attractive from a tactical perspective. But medium term, we still expect USD advantage to be eroded by eventual gradual stronger growth trends in rest of the world and assist USD reversion towards fair value but at slower pace compared to the past.***

- The recent July FOMC statement plus the latest probabilities of Fed's rate hike in the next three remaining FOMC meeting this year derived from the fed fund futures suggests the third rate hike is unlikely to happen at the 19-20 Sep 2017 and the 31 Oct – 1 Nov 2017 FOMC meetings given the above-90% probability of no change, although the odds of a hike at the final FOMC meeting of the year on 12- 13 Dec 2017 is relatively high at 40%. Still, the 19-20 Sep 2017 FOMC is important as we expect Janet Yellen to provide more colour on Fed's next move at the post-FOMC meeting press conference. Meanwhile, minutes of the 25-26 July 2017 FOMC will be out on 16 Aug 2017. We are not ruling out a third rate hike at the Dec 2017 FOMC and the start of Fed balance sheet's reduction in 4Q 2017.

- We continue to expect domestic data and a repricing of the future stance of monetary policy to support the USD. But given further delays in the US tax reforms (possibly in middle of 2018) and trade policies as well as softer inflation pressures to support a strong US reflation view, we do not expect the Dollar to appreciate as strongly as expected in 2017. **Nonetheless d**uring this phase and around FOMC announcements, we believe the **USD could still be mildly supported at times given potential concerns about Fed changes in FFR guidance on hikes and balance sheet normalisation.**

- **Growth and Inflation Outlook:** The latest 2Q advanced GDP came in at 2.6% compared to 2.7% expected, while 1Q GDP numbers were revised down to 1.2% from 1.4% previously, indicating a slower start to 2017 after the 2016 GDP was revised down to 1.5% from previous 1.6%. The second quarter saw increases in household spending, commercial construction, exports and federal spending, while homebuilding, business inventory investment and state and local government spending were down. Higher imports also weighed on GDP growth.

- Non-farm payroll employment growth rose to 222k from an upwardly revised 152k in May, stronger than consensus (178k) expectations. The improvement was broad-based, as private sector employment rose to 187k and government payrolls rose by a strong 35k. Within the private sector, goods-producing sectors added 25k on the month, while services employment growth accelerated to 162k. However, earnings growth remains soft again in June, with average hourly earnings (AHE) up only 0.2% m/m and 2.5% y/y, versus expectation for a 0.3% monthly increase. In addition, May data were revised lower by one-tenth and now show AHE up 0.1% m/m and 2.4% y/y.

- US CPI inflation was a bit below consensus expectations of a 0.1% rise. On a y/y basis, CPI rose 1.6%, slowing significantly from 1.9% previously. Core inflation rose 0.1% m/m and 1.7% y/y. Energy prices fell (-1.6% m/m), the second consecutive decline. Food prices were flat on the month, taking a breather after rising consistently since January.

- Headline CPI was broadly as expected, but core CPI surprised on the downside again - the fourth month in a row in which core price inflation has disappointed. While we think the recent weakness will weigh on year-over-year inflation for some time, we do think inflation pressures will gradually start to pick up toward the end of this year. Labor markets remain strong, slack is diminishing and the output gap is nearly closed. Turning to the Fed, communications from FOMC members have been clear that they view the recent weakness in inflation as transitory and that they remain focused on a tightening policy path. And we believe the Fed could start balance sheet runoff as early as the September meeting. The recent softness in core inflation puts at risk our call that the Fed will be able to raise rates for a third time in December, in particular if the inflation trend fails to firm up during the second half of the year.

- Monetary Policy Forecast: The Fed funds rate was kept at 1.00%-1.25%. FOMC statement on inflation and balance sheet normalisation raised uncertainty on timing of next rate hike and start of balance sheet reduction. We are not ruling out third rate hike in Dec 2017 FOMC and commencement of balance sheet reduction in 4Q 2017.

- Two things stood out in the latest FOMC statement. First, remarks about headline and core inflation rates shifted to "have declined and are running below 2%" vs "has declined recently and... is running somewhat below 2%", suggesting Fed acknowledged the risk that the low and slow inflation may not be temporary and can be more persistent, although Fed retains it view that while the sub-2% inflation rate will continue in the near term, further strengthening in the labour market conditions will facilitate a sustainable return to 2% inflation in the medium term.

- Secondly, remark on the expected start of the balance sheet normalisation programme changed to the somewhat opaque “relatively soon” from the explicit “this year” in the June 2017 FOMC Statement, planting some doubts as to whether the unwinding of Fed’s securities holdings accumulated over the years from the three rounds of asset purchase programmes or quantitative easing (QE) can kick off this year. Markets interpreted these changes as signalling potential delays in further FFR hike and the roll out of balance sheet reduction, which caused USD Index and US Treasury yield to fall.

- The recent FOMC statement plus the latest probabilities of Fed’s rate hike in the next three remaining FOMC meeting this year derived from the fed fund futures suggests the third rate hike is unlikely to happen at the 19-20 Sep 2017 and the 31 Oct – 1 Nov 2017 FOMC meetings given the above-90% probability of no change, although the odds of a hike at the final FOMC meeting of the year on 12- 13 Dec 2017 is relatively high at 40% (Figure 1).

- Still, the 19-20 Sep 2017 FOMC is important as we expect Janet Yellen to provide more colour on Fed’s next move at the post-FOMC meeting press conference. Meanwhile, minutes of the 25-26 July 2017 FOMC will be out on 16 Aug 2017. We are not ruling out a third rate hike at the Dec 2017 FOMC and the start of Fed balance sheet’s reduction in 4Q 2017.

- **Latest Fiscal and External Balance Outlook:** Fiscal policy should be expansionary over the next few years as the tax reforms take shape and some investment in infrastructure becomes apparent under the Trump administration. The deficit has fallen sharply from its peak. Fiscal sustainability risk continues to weigh on the outlook and may emerge sooner than later. In the long term, an improved US economy and manufacturing sector, US shale oil and gas production may improve the US current account leading to dollar support but this is likely to be long drawn and may probably begin only in 2018. The US other deficits – current account and BOP deficits have moved slightly wider and is expected to continue.

- **Key domestic events and issues to watch in Aug 2017:** Key US events: ISM Manufacturing (1 Aug); Factory Orders (3 Aug); Durable Goods Orders (25 Aug); NFP (4 Aug); CPI (11 Aug); Retail Sales (15 Aug); GDP 2Q (30 Aug); PCE Deflator (1 and 31 Aug), Housing Starts (16 Aug); FOMC Meeting Minutes (17 Aug); Trade Balance (6 Aug); Fed Jackson Hole Meetings 24-26 Aug.

- **Technical Outlook:** DXY index fell to 13-month low of 93.15 (27 Jul) and YTD DXY has fallen by about 10%. It was last seen at 93.50 levels. Monthly momentum and stochastics indicators continue to suggest a bearish bias. Next key support level at 91.80 (38.2% fibo retracement of 2011 low to 2016 high), 88 levels (50% fibo) before 84.60 (61.8% fibo). Weekly and daily stochastics at oversold conditions suggest rising risks of rebound. Resistance seen at 95.60, 96.20 levels.

EUR: Positive Outlook but Risk of Correction

Forecast	3Q 2017	4Q 2017	1Q 2018	2Q 2018
EURUSD	1.1600 (1.1250)	1.1700 (1.1400)	1.1800 (1.1500)	1.1600 (1.1300)

Previous Forecasts in Parenthesis

- **Motivation for the FX View: We maintain our positive view on the EUR and reiterate it is a story of bottoming and remains a buy on dips on a combination of factors including** (1) sustained signs of economic recovery broadening in Europe; (2) receding political risks in Europe (early this year we were cautious due to Netherlands and French elections and the wave of support for Right wing) and most importantly (3) increasing signs that ECB may signal some removal of monetary stimulus in due course if inflation continues to rise higher. But the sharp move of about 5.3% since mid-Jun may be overdone in the short term as hopes for ECB removal of monetary stimulus may have been overdone. We do not rule out the risk of correction, potentially towards 1.15, 1.1350 levels should ECB disappoints or inflation stays subdued. We are not in favor of chasing EUR longs at current levels and favor buying on dips. We maintain our view of EUR long vs. JPY, on the basis that ECB is likely to normalize policies ahead of BoJ. Given recent market development, we calibrate our EUR forecast higher across the forecast horizon.

- ECB Draghi's mention of Autumn as a potential time period to make a decision regarding any change on forward guidance (at the ECB meeting on 20 Jul) has resulted in rising hopes and expectation that ECB could soon announce some form of tapering or normalization and that sparked off the recent leg in the EUR rally. We caution that the timing given by Draghi was not entirely specific - traditionally Autumn starts with the equinox on 22 Sep and the next ECB meeting (7 Sep) is before the equinox and German Federal elections (24 Sep). There are risks that the markets may have over-read Draghi's words and positioned for a potential tapering decision way too early. We believe inflation pickup in EU remains very gradual and ECB's stance for considerable degree of monetary accommodation for inflation dynamics to become durable and self-sustaining is likely to be followed through (unless there are very strong positive shocks to demand). Tapering decision if any, is likely to be gradual and rates are expected to stay low for longer. There is no need for ECB to rush into tapering or normalization. We do expect some form of slower purchases of QE, potentially announced after 7th Sep meeting. The remaining meetings for ECB this year are scheduled on 26 Oct and 14 Dec. Disappointment with ECB's action may see EUR longs reducing its position and result in corrective moves lower in the EUR.

- **Potential Downside Risks to our Outlook:** We do caution there are risks ahead that may limit EUR gains or even subject the EUR to some temporary downside pressure – (1) disappointment with ECB on monetary policy normalization timeline, in particular focus on Jackson Hole Forum (24 – 27 Aug) where ECB's Draghi is expected to speak and markets are somewhat expecting a hawkish spin and ECB meeting (7 Sep) which markets are expecting some form of discussion or announcement of QE tapering; (2) Upcoming German Federal election in Sep should warrant some caution as election campaign may intensify as we get closer to election day and may temporarily swing sentiment and the EUR (though we do note that polls and election forecast models currently indicates that Merkel remains in the lead); (3) risk of Italy calling for early elections – and could dampen investor sentiment, heightens political uncertainty and weigh on EUR (previously there were talks that Italy may hold its elections the same day as Germany); (4) return of monetary policy divergence with Fed especially if US data (in particular inflation, wage growth) surprise to the upside. That will encourage market to re-price Fed's monetary normalisation plans and put upward pressure on UST yields and the USD.

- **Growth and Inflation Outlook:** Euro-area recovery continues with 16 quarters of growth and 6.4m jobs created since the recovery began. But forward looking surveys shows signs of moderation. Flash Manufacturing PMI slipped to 56.8 (vs. 57.4) while services PMI held steady (55.4) after a pullback in the last month. That said these PMIs still indicate an expansion in business activities.

- **2Q GDP is scheduled for release on 1 Aug**. To recap, 1Q GDP was revised higher to 0.6% q/q (vs. 0.5% in first reading) owing to better than expected performance in France, Italy and Greece. All 19 Eurozone member registered positive growth while unemployment has also fallen to its lowest level (9.3%) since 2009.

- In the last quarterly assessment report (8 Jun), ECB modestly revised 2017 and 2018 growth to 1.9% and 1.8% (from 1.8% and 1.7%), respectively. ECB acknowledged that risks are now "broadly balanced" (a shift from "tilted to the downside" in last ECB statement) and there is stronger momentum in the Euro-area economy. **The next quarterly assessment is due at the 7 Sep ECB meeting.**

- **Euro-area inflation slowed in** Jun, with headline CPI decelerating to 1.3% y/y (vs. 1.4% in May) but core inflation picked up slightly (1.1% y/y vs. 0.9% in May) owing to service inflation. Overall inflation has remained relatively subdued and the pick-up remains very gradual. Moreover a stronger EUR could also weigh on imported prices (imported consumer products account for around 15% of industrial goods in the Euro-area) and result in negative feedback loop to core inflation.

- Our inflation forecast shows headline inflation may reach a high of 1.5% in 3Q (still below ECB's "around 2%" target) before easing off towards 1.2% in 4Q 2017 and then gradually pick up again for 2018 and 2019. ECB's policy mandate is to maintain inflation rate below but close to 2% over the medium term. Current level of inflation confirms Draghi's point that core inflation has yet to see a meaningful recovery. In Draghi's words, for inflation to be considered as 'sustained adjustment', there are four elements that need to be fulfilled: Inflation (1) is affecting the medium term, (2) is durable, (3) is self-sustained and (4) is region wide. So far it remains too soon to conclude that the four elements above are met as core inflation continued to hold around 1% y/y.

- But we do note that ECB's Draghi has recently shifted his view on inflation. He said temporary factors are weighing on the path of inflation and the central bank can look through it. He shared that the transmission of rising demand to rising inflation has been more subdued than in the past and there are several factors weighing on the path of inflation, including (1) external shock to energy and commodity prices depressing cost of imported energy and producer prices; (2) size of output gap and its impact on inflation; (3) extent to which current period of persistent low inflation feeding into price and wage setting in a more persistent way and that these factors have been relevant for the delayed reaction of inflation to the recovery.

- We pay close attention to his view on inflation – if he elaborates further at the upcoming Jackson Hole Symposium (24 – 27 Aug), where he is scheduled to speak after 3 years of absence. Expectations are building up for him to signal the removal of monetary stimulus soon and these could keep EUR long bets in the money. Recall that back in Aug-2014 when ECB's Draghi last spoke at Jackson Hole Symposium, he made strong comments that inflation expectations had fallen "at all horizons" and subsequently that paved the way for an expanded asset purchase program in Mar-2015. So the upcoming appearance can be symbolic especially when he had said that deflationary forces is gone and reflationary forces are at play at the ECB Forum (26 – 28 Jun 2017).

- In the last quarterly assessment report (8 Jun), the ECB revised inflation forecast lower to 1.5% for 2017 (vs. 1.7% in prior report) and to 1.3% for 2018 (vs. 1.6% in prior report) despite acknowledging the strength of the Eurozone's accelerating economic growth. The downward revision was due to lower oil and food prices. **The next quarterly assessment is due at the 7 Sep ECB meeting.**

- **Monetary Policy Forecast: No ECB meeting is scheduled for Aug. The next meeting is on 7 Sep.** We expect ECB to keep monetary policy status quo, after its decision (back in Dec 2016) to extend QE (at a reduced pace of €60bn per month) till end 2017.

- We do acknowledge there is potentially some risk for ECB to normalize monetary policies in the form of slowing its asset purchases (currently at the pace of EUR60bn on monthly basis till end-2017). Still a reduction in QE purchase only constitutes to tapering and is in no way close to tightening interest rates. We still expect ECB to maintain a considerable degree of monetary accommodation for inflation dynamics to become durable and self-sustaining. We do expect some form of slower purchases of QE, potentially announced after 7th Sep meeting. But tapering moves if any is likely to be gradual and rates are expected to stay low for longer.

- At the last ECB meeting (20 Jul), ECB kept monetary policy and rates unchanged. It reiterated its forward guidance that rates will remain at present level for an extended period and that QE will be maintained at current pace until inflation has sustainably adjusted.

He also said the QE can be adjusted in size or duration if the economic outlook worsens or financial conditions become inconsistent with further progress towards a sustained adjustment in the path of inflation. **There were neither further tweaks to policy statement nor any specifics to ECB taper except that the ECB may make a decision in Autumn any change in forward guidance.**

- To recap, QE was extended beyond Mar 2017 for another 9 months to end-2017, at a reduced pace of €60bn per month. There were also a handful of technical tweaks to the APP to ensure smooth implementation of the program. Our take is ECB's monthly purchase after Apr 2017 may seem like a tapering at first glance but in actual fact, the option chosen between the 2 (either €80bn per month for 6 months or €60bn per month for 9 months) implies a larger QE amount (€540 bn).

- **Latest Fiscal and External Balance Outlook:** Euro area's current account surplus widened to EUR30.1bn in May (from EUR23.5bn in Apr), thanks to trade surplus and primary income. Current account surplus to GDP remains at 3.2% for 12-month period ending May 2017.

- The government deficit ratio is projected to decline to 1.5% in 2017, from 2.1% of GDP in 2015. Projected government debt ratio is projected to decline gradually to 88.4% in 2017, from 91.5% of GDP in 2015.

- **Key domestic events and issues to watch:** Advanced estimates of 2Q GDP, Jul Mfg PMI (1 Aug); Jun PPI (2 Aug); Jul Services PMI, Jun retail sales (3 Aug); Jul Retail PMI (4 Aug); Jun IP (14 Aug); 2Q prelim GDP (16 Ag); Jul CPI, Jun trade, ECB Meeting Minutes (17 Aug); Jun Current account (18 Jun); Aug Flash PMI, Aug consumer confidence (23 Aug); Jul unemployment rate, Aug CPI (31 Aug)

- **Technical Outlook:** EUR looks on course to close higher for the 5th consecutive month in a row, at time of writing. Pair was last seen at 1.1740 levels. Uptrend remains intact, as indicated by monthly, weekly and daily momentum charts. But big resistance at 1.1750 levels (200WMA, 38.2% fibo retracement of 2014 high to 2016 low). Break above this could open the way for EUR towards 1.2180 levels (50% fibo). But prior to that, a pullback from recent gains towards 1.15, 1.1220 support levels cannot be ruled out.

GBP: Not Yet Time to Raise Rates

Forecast	3Q 2017	4Q 2017	1Q 2018	2Q 2018
GBPUSD	1.3150 (1.3200)	1.3000 (--)	1.2900 (--)	1.3200 (--)

Previous Forecasts in Parenthesis

- **Motivation for the FX View**: We expect GBP to trade within 1.29 - 1.32 range with the upside driven by market expectation for BoE to tighten monetary policy (not our base case scenario) while uncertainties around *Brexit* and ongoing deceleration in growth momentum counteract. We do caution that absence of USD strength may result in GBP to overshoot our upper-bound range. However on tactical basis, we are biased to lean against GBP strength as macro-fundamentals are starting to show more signs of weakening. Though market expects BoE to tighten and inflation overshooting target does support the case for tightening, we are not of the view that BoE will tighten at the upcoming meeting as decelerating growth momentum is expected to weigh on macro-fundamentals and *Brexit* uncertainties still remain. We revised GBP forecast for 3Q slightly lower to account for a potentially less hawkish MPC.

- Our recent study on central banks' inclination to tighten monetary policy by comparing UK's forecasted path of inflation, BoE's policy mandate and accounting for BoE policy transmission lag suggests that the BoE could potentially raise rate in upcoming Aug or Nov meeting. We do acknowledge that the overshoot of inflation target is due to GBP's large depreciation post-Brexit in 2016 feeding through to inflation via import price channel and the BoE is well aware and has shared its tolerance of above-target inflation. They have also expected inflation to potentially rise above 3% by Autumn. Current level of inflation has already overshot BoE's inflation target of 2% and is nearing the temporary threshold of 3%. If BoE is determined to achieve its policy mandate objective and keep rising prices in check, the bank could tighten soon. We do however caution that tightening monetary policy amid slowing growth momentum may not be the best scenario mix for UK and could further put pressure on the growth momentum. And if BoE steps away from hawkish talk, GBP gains could fade and the currency may face a sharper correction lower. **Our base case scenario remains for BoE to remain on hold though we do see rising risk of BoE raising rate from record low of 0.25% to 0.50% at the upcoming meeting but the pace of tightening will not be aggressive (if BoE were to tighten). We will adjust our base case scenario if upcoming data - business investments and wage growth firm further and offset weaker consumption.**

- Recent headlines out of Europe suggest that the **pace of *Brexit* negotiation is slow and trade talks (only allowed after a deal on citizens' rights, money and Irish borders have been agreed) between EU and UK are likely to be delayed**. The first stage of negotiation (till Oct) is focused on **citizen rights, a financial settlement and other separation issues with a separate dialogue on N. Ireland, with talks** scheduled in the weeks starting 28-Aug, 18-Sep and 9-Oct. The first two rounds of negotiations have seen *Brexit* talks stalled over the exit bill and guaranteeing citizens' rights, in particular the role of European Court of Justice in protecting them. Much uncertainty relating to whether London still hold as a financial hub, if investments inflows will slow and lead to weaker labor market or if jobs get relocated, remain unknown. Recent development saw Nomura and Daiwa picking Frankfurt as its post-Brexit HQ and will move jobs out of London. Deutsche Bank is also considering moving 1/5 of its balance sheet from London to Frankfurt. JP Morgan, UBS and Goldman Sachs also mentioned moving staff out of London. Certainly these job losses have yet to materialise and may still be at early stages but eventually when consideration translates into decision, the pain will be felt and GBP is expected to bear the brunt of the painful *Brexit* consequences.

- We maintain our medium term (18 - 24month) bias that GBP could trade higher from current levels towards 1.35 – 1.40 as GBP is perceived to be undervalued from both historical and fundamentals perspective (our BEER model puts GBP at 1.40). The 20% or so depreciation since referendum results (Jun 2016) should help the UK economy to rebalance and grow sustainably over time - current account deficit should narrow, exports should become more competitive and tourism and education receipts should pick up further. We believe UK should be able to manage the exit, transform itself into a global marketplace and continue to attract capital (longer-term). Past experience of UK leaving the ERM back in 1992 saw a period of consolidation (for a few years) at historical lows for GBP, before the eventual move higher in the following years, where GBP TWI traded above 100-levels in 1998 (from the lows of 80 in 1993-1996) due to buoyant demand fueled by rapid growth of wealth, credit and money. If history is a guide (assuming UK manages the transition well and takes the opportunity to correct its imbalances), its currency may start climbing higher.

- **Growth and Inflation Outlook:** 2Q GDP came in as expected (0.3% q/q and 1.7% y/y) and was a slightly higher than 1Q (+0.2% q/q). But cumulatively for 1H, the data confirms that UK is in "notable slowdown" (according to Office for National Statistics). This is consistent with our long-standing caution that UK growth momentum is slowing. Forward looking surveys including manufacturing, services and construction PMIs all surprised to the downside for Jun while industrial, manufacturing production and construction output continue to shrink in Jun. **Downside surprise to economic data remains consistent with our call and we expect downside surprise to persist in the months ahead.**

- **UK inflation slowed to 2.6% in Jun from 4-year high** of 2.9% in May. Unexpected slowdown was largely driven by lower prices at petrol pump, recreation & culture and clothing, footwear and housing. Inflation overshoot is above BoE's target of 2% and was increasingly testing the tolerance of some BoE policymakers but the surprise slowdown might give policymakers some breathing space. Core inflation (ex food and energy) also slipped to 2.4% (from 2.6% in May). While inflation may inch closer to 3%, we do not expect price pressures to be self-sustainable as effects from travel (Easter holiday), fuel prices ease and GBP stabilization from depreciation could stabilize import price pressures.

- **Monetary Policy Forecast: Our base case scenario remains for BoE to keep monetary policy rate on hold (at the upcoming meeting on 3 Aug)** as premature tightening to arrest inflation may upset growth momentum especially in an environment of slowing growth, potential consumer squeeze and *Brexit* negotiation uncertainty **but we flag the rising risk of BoE raising rate from record low of 0.25% to 0.50% at the upcoming meeting** given that from an inflation standpoint, the BoE is behind the curve. And even if BoE does raise rate, **we believe the pace of tightening will not be aggressive. We may adjust our base case scenario if upcoming data - business investments and wage growth firm further and offset weaker consumption.**

- We acknowledged the shift in MPC towards the hawkish camp but **remain little convinced that the balance of the MPC will shift unless data - in particular business investment and wage growth surprise to the upside.** There are 8 MPC members - outgoing MPC member Kristin Forbes (dove) has been replaced by Prof. Silvana Tenreyo as an external member and we will be paying close attention to her speeches to sieve out any dovish or hawkish leaning. In her previous role as MPC member at Bank of Mauritius, she has never voted for a rate hike in the 11 rate decision meetings she participated in. Last year in the FT annual survey of Economists, she said a hard Brexit would have a substantial effect on immigration flows and possibly emigration and the effects on the UK economy will certainly be negative; many firms will need to rethink and reorganize production as they lose talented workers. **We think she may well vote for no rate increase at the next meeting.** Assuming BoE bank staff sticks to keeping rates on hold, we may see the MPC vote 6-2 to keep rate unchanged. Even if Andrew Haldane (Chief Economist and MPC member) switches for a rate hike – the MPC may still be short of votes to raise rates at the Aug meeting unless BoE Governor Carney switches camp (he is a wild card to the shift). BoE will operate with full 9 members on board come Sep as Sir David Ramsden has just been appointed as the Deputy Governor for Markets and Banking and a member of the MPC (effective 4 Sep). He was formerly the Chief Economic advisor to the Treasury and has worked across economy policy areas since 1988 and initial assessment is he is likely to be considered dovish. And that suggests the **BoE MPC is likely to be skewed back towards the dovish camp.**

- At the last MPC meeting (15 Jun), BoE MPC voted 5-3 to keep rates on hold. Markets were expecting MPC to vote 7-1 to keep rates on hold. The camp (Kristin Forbes, Ian McCafferty, Michael Saunders) which dissented noted its “reduced tolerance” of an inflation overshoot and argued that some withdrawal of last year’s stimulus is required to moderate inflation overshoot. The other 5 members (voted to keep rate unchanged) argued that it remains too early to rule out a renewed slowdown in growth as the slowdown in household consumption and GDP has recently begun.

- **Latest Fiscal and External Balance Outlook:** UK's budget deficit widened in Jun as higher inflation since *Brexit* vote forced the government to pay more interest on its debt – spending on debt interest jumped 33% y/y in Jun to GBP4.9bn – the highest for any month of Jun since 2011, reflecting a sharp rise in inflation which has pushed up the cost of index-linked bonds for the government. While income tax and corporate gains tax revenues increased, the decline in corporate tax revenues outweighed the gains. Though Budget deficit has been greatly reduced to 2.4% of GDP from about 10% of GDP in 2010, the deficit is likely to re-widen again to 2.9% of GDP this year.

- Debt to GDP ratio is now projected to decline from 88.8% in 2017/18 to 88.5% in 2018/19 and 79.8% in 2021/22. The budget took into account fresh updates to 2017 growth forecast (2%, from 1.4% previously).

- UK's current account deficit to GDP narrowed further to -3.9% of GDP for 1Q 2017 from about -4.4% of GDP for 4Q 2016. Improvement was due to trade deficit narrowing (thanks to increase in exports amid softer GBP)

- **Key domestic events and issues to watch:** Jul Mfg PMI (1 Aug); Jul Construction PMI (2 Aug); Jul services PMI (3 Aug); BoE meeting (3 Aug) Jun IP, construction output, trade (10 Aug); Jul CPI, PPI, RPI (15 Aug); Jun jobs report (16 Aug); Jul retail sales (17 Aug); public finances (21 Aug); 2Q GDP (24 Aug).

- **Technical Outlook:** GBP continue to trade higher, above 1.30-handle. Last seen at 1.3120 levels. Bullish momentum on monthly, weekly and daily charts remain intact. Sustained price action above 1.3060 (38.2% fibo retracement of 2016 high to low) should see GBP trade closer to 1.32, 1.3420 (50% fibo) levels. Support at 1.30 (21 DMA), 1.29 (50 DMA).

AUD: Atop of 0.80

Forecast	3Q 2017	4Q 2017	1Q 2018	2Q 2018
AUDUSD	0.81 (0.76)	0.80 (0.80)	0.78 (--)	0.82 (0.78)

Previous Forecasts in Parenthesis

- **Motivation for the FX View:** AUDUSD has made another sharp move higher, atop of 0.80, helped by firmer iron ore prices, the retreat in the USD as well as signs of stability in demand out of China. Iron ore prices have retested the 70-mark for the second time this month. We still see potential for retracements in the metal prices and AUD but dips could be shallow. Recent strength in the local labour report certainly helped too but with the wage growth still low, household debt to disposable income ratio still high (at 190%) and increasing reliance on the services sector, a rate hike may not come until we are well into 2018. This is all the more underscored by the comments by RBA Debelle and Lowe that Australia does not need to join the rest of G7 majors who are looking to normalize policy rates or remove stimulus (BOC, ECB, BoE). A firmer AUD could still undermine the exports of services. Growth is still primarily supported by household demand as what we have seen in 1Q. That leaves RBA unlikely to lift rates for fear of strengthening the AUD and rates that could crimp on private consumption.

- **Still, even as** RBA is unlikely to move within the next few months, we see AUDUSD higher, underpinned by stability in metal prices and less drag from the sluggish USD. We shift our AUDUSD for 3Q towards 0.80 taking into account these considerations. Also, with recent data indicating nascent signs of sustained economic recovery, we feel confident enough to lift our AUDUSD forecast towards the 0.81-level by year-end.

- **Growth and Inflation Outlook:** The trade surplus of goods remained somewhat steady in May and Apr compared to the trade surplus in the first three months of the year. Export receipts remained strong in May and that was also accompanied by robust growth in imports bill. While inflows via trade surplus of goods continue to keep current account deficit narrow, we are also wary of the rising outflows via the primary income. The seasonally adjusted current account narrowed slightly to AUD3.1bn in 1Q vs. previous AUD3.5bn. Looking at the trade numbers for the past few months, it is likely that the current account surplus will remain steady thereabouts for the second quarter. Still, we are wary that rising payouts of employee compensation, direct and portfolio investment could widen the current account deficit in the next few quarters.

- Much optimism has been placed on the improving labour market conditions in the past few months. Hiring growth has been on the acceleration on a seasonally adjusted basis, +2.0%y/y for Jun from around 1% at the start of the year and an increasing portion of the hires have been for full-time rather than part-time. This is in spite of rising labour participation. While RBA Lowe has warned that low wage growth could be something to get used to due to structural change in the economy, technological shocks and simply competition, he has also been repeatedly commenting on his expectations for wage growth from an improving labour market. Wage growth has only managed to eke out a slight acceleration from its historic lows of 0.4%q/q growth seen in 2016 Q4 to 0.5%q/q in 2017 Q1. That can only be described as nascent sign of wage growth bottoming, not a robust rebound like what is observed in Canada. Furthermore, the unit labor cost index has been on the decline. The fall of productivity could weigh on wage growth in the medium term. We watch for the 2Q wage price release on 16th Aug. Stronger wage growth could see AUD bulls press on and raise inflation expectations.

- **Monetary Policy Forecast:** We maintain our view for RBA to hold cash target rates at 1.5% for the rest of this year. The release of the Jul minutes had markets latching onto the mention of “neutral rate” at 3½ percent and driving the AUDUSD towards the 0.80-figure. However, central bank Govenors Lowe and Debelle then clarified that there should not be any significance attached to the mention of the neutral rate. More importantly, market players should not assume that RBA will join the rest of the more hawkish G7 central banks in monetary policy tightening. RBA Lowe particularly reminded that just as the Australia's policy rate was not lowered as much as those of BOC, ECB and BOE, RBA will not need to raise the cash target rate in lockstep with them as well.

- RBA has been sounding neutral for a while now and is likely to take this neutral tone into next year. While there has been plenty of comparison between Canada and Australia, Canada has seen a faster pace of real wage recovery than Australia. The stage of economic recovery is just not comparable between two countries although RBA has been sounding optimistic. With household debt at 190% of disposable income, a rise in rates could affect household consumption in an environment of low wage growth. A stronger AUD could also, still derail the recovery in the retail sales which has picked up pace to 3.8%y/y (s/adj) from previous 3.1%, strongest pace seen since last Apr. Hence, while risks to rates seem to have tilted to the upside more recently, the AUD direction is more likely to be dictated by the USD, China's ability to maintain its growth stability, metal price swings and concomitant impact from its terms of trade.

- In the meantime, Australian bond yields rose in the last week of Jun and 10y yield remained steady around 2.67% for most of Jul. Bear steepening in sovereign curve was driven by the lift in most G7 bond yields, spurred by the hawkish comments from ECB, BOC and BOE at the ECB forum. The widening AU-US yield differential has lent support to the AUDUSD. Low volatility environment could continue to boost the demand for good quality and positive yielding bonds such as Australia's. Softened inflation prints observed of late could also continue to buoy demand for bonds.

- **Latest Fiscal and External Balance Outlook:** As reported in May, the 2017-18 budget deficit is A$29.4bn and projected to return to a surplus of A$7.4bn by 2020-21. Economic assumptions include inflation at 2% this year, real GDP of 2.75%. Total revenue is expected to be A$444.4bn, up from A$412.1bn in 2016-17. Net debt is projected to peak at 19.8% of GDP in 2018-19. Infrastructure spending will amount A$75bn from 2017-18 to 2026-27. More spending also on early learning and childcare via new system of fee subsides. Cuts seen in tourism, public service (diplomats). More revenue is to be generated from visa application, cigarettes levy and taxes on banks' liabilities. The budget managed to help the government avert a loss of its AAA rating by S&P but uncertainties of its revenue projections saw the rating agency maintain a negative outlook for Australia.

- **Key domestic events and issues to watch:** M-I inflation, Jun private sector credit due on Jul 31st. RBA meeting on 1st Aug, building approvals on 2nd, trade on 3rd, retail sales on 4th, NAB business survey on the 8th, home loans on the 9th, RBA minutes on the 15th, 2Q wage price index on the 16th, labour report on the 17th, building approvals for Jul on 30th Aug, private sector credit for Jul on 31st along with **2Q CAPEX.**

- **Technical Outlook:** AUDUSD has arrived at the top of 0.80. Weekly momentum is bullish though stochs flag overbought conditions. Daily stochs also falling from stretched positioning and momentum is also turning bearish. Also keep in mind that August is a seasonally bearish month for the AUDUSD. We see risks of a retracement towards the 0.7850 (23.6% Fibonacci retracement of the May-Jul rally) and then towards the 21-DMA, last penciled in at 0.78. Medium term outlook is still bullish and we look for opportunities to buy on dips.

NZD: Strength Overdone; Risk of Retracement

Forecast	3Q 2017	4Q 2017	1Q 2018	2Q 2018
NZDUSD	0.7300 (--)	0.7500 (--)	0.7700 (--)	0.7600 (--)

No Change to Previous Forecasts

- **Motivation for the FX View:** While we remain broadly positive on NZD owing to solid underlying fundamentals - resilient growth underpinned by tourism and consumer spending, rising budget surplus, etc. and improvement in dairy sector, we believe the recent rally in the Kiwi was due to the absence of USD strength and expectation that other major central banks could be start to normalize monetary policy (BoC has raised rate by 25bps). The sharp rally in the Kiwi may have been overdone. NZ TWI has risen more than 6% since the lows in May-2017 to 79-levels. This is level not seen since Feb 2017 and back then RBNZ did express discomfort with the NZD strength and desire for a weaker currency. Our in-house fair value model based on real yield differentials, current account differentials and reflation proxy puts NZD at around 0.72, and we expect NZD to face some correction in the coming weeks. Moreover NZ General Election is scheduled for 24 Sep and some degree of election uncertainty could induce a pare-back of NZD record long positioning and weigh on NZD.

- Other factors that could drive NZD lower on a temporary basis include (1) softer 2Q inflation print (which was in line with our expectation as mentioned in the last monthly outlook) should ease market expectation for a rate hike; (2) risk of debt-to-loan limits being added to RBNZ macro-prudential toolkit (which is undergoing consultation now and could be added as soon as Aug-Oct) – may weigh on house prices and investor sentiment and subsequently on the NZD; (3) continued narrowing of NZ-UST yield differentials (2Y eased to 62bps from 75bps in mid-Jul) should weigh on the NZD amid the widening of current account deficit (-3.1% of GDP). The corrective move lower could be exacerbated especially when NZD long positioning is now at record high.

- Potential inclusion of debt-to-income (DTI) limits to RBNZ's macro-prudential toolkit may come as early as in Aug-Oct this year especially with household debt to income surging to historical high of 167.90% in 4Q 2016. Past episodes of introduction of macro-prudential tools weigh on investor sentiment and on NZD, and we expect a similar round of effect, if DTI is introduced.

- Apart from election risk in NZ, leadership transition at RBNZ due to change of RBNZ Governor from Graeme Wheeler to Grant Spencer (as acting Governor for 6 months before retirement), effective 26 Sep, may result in monetary policy staying status quo till Mar-2018 unless inflation overshoots upper band of target range of 3%
- As such we maintain our NZD forecast across the forecast horizon, expecting Kiwi to stay softer for 3Q but to gradually rise into 1Q 2018, due to RBNZ rate hike expectations and domestic resilience.
- **Growth and Inflation Outlook:** NZ's economy is expected to continue growing at an average of 3.1% over the next 5 years, according to PM English (25 May). Though NZ construction sector (accounts for 6.5% of GDP) could peak this year as investments in residential building construction slows, activity should remain high and the economy should still be supported by tourism, immigration, consumer spending and exports. We continue to **expect the NZ economy to outperform most of G7 economies this year.**
- **2Q GDP is scheduled for release on 19 Sep.** 1Q GDP growth (released on 15 Jun) disappointed (+0.5% q/q vs. +0.7% q/q expectation) owing to the contraction in construction sector and mixed results for services sector. Breakdown by industry level showed 11 out of 16 industries increased in 1Q – agriculture (thanks to milk production), accommodation and retail trade outperformed while construction, transport were down. In terms of expenditure level, household consumption saw its biggest increase in over a decade, overall investment also increased owing to strong investment in plant, machinery and equipment (strongest level in nearly 7 years) despite slower building activity while net exports was down. **NZ PMI fell to 56.2 in Jun from 16-month high of 58.2 in May.** All 5 sub-indexes including employment declined.
- **2Q CPI slowed to 0% q/q from 1% in 1Q,** owing to decline in fuel costs and airfares, telecommunication products and services. On y/y basis, 2Q CPI moderated to 1.7% (vs. 2.2% in 1Q). A stronger Kiwi over the past few months may also have dampened imported price pressures. The softer than expected print should dampen market speculation for earlier than expected rate hike and remains consistent with RBNZ Wheeler's earlier comments that the spike in 1Q inflation is likely to be temporary and may lead to some variability in headline inflation.
- Recent RBNZ studies also showed that traditional drivers of inflation – high immigration and construction spending – are less inflationary in current episode vs. previous episodes of economic expansion. RBNZ attributed this to two reasons: (1) current immigration cycle has a larger share of younger migrants (17-29 years old) and they tend to have a small impact on net demand and inflation than older migrants (Vehbi, 2016) and (2) weakness in Australian labor market resulted in higher unemployment and less inflation pressure (Armstrong and McDonald, 2016) than if migrants were being drawn by strength of NZ economy or for other reasons. Large construction spending should

typically result in rising price pressures. But in the Canterbury rebuild after two large earthquakes in Sep-2010 and Feb-2011, the degree of spillover from construction costs to CPI was much less than expected. According to RBNZ studies, domestic and foreign labour markets as well as immigration policy appear to have been flexible to prevent a dramatic increase in national wages and inflationary pressure. Looking ahead, construction sector (accounts for 6.5% of GDP) is expected to peak sometime this year as residential investments slowed. A report released by Building and Construction in NZ 2017-18 noted that the longest and strongest construction sector growth phase for NZ will peak soon but activity levels will remain high for some time. We also noted that new residential building consents fell 7.6% m/m in Apr and construction sector saw its first contraction (-1% q/q) in 1Q for the first time in 6 quarters. 1Q inflation breakdown also showed that though construction costs rose by 6.7% in the year to Mar-2017, the quarterly rate of construction cost inflation moderated over late-2016 and early-2017 due to slower growth in residential investment. Should residential investment continue to moderate, the inflation pressure contributed by construction sector could pose smaller risk.

- **Monetary Policy Forecast:** We expect RBNZ to keep OCR on hold at record low of 1.75% at the upcoming meeting (10 Aug). Accompanying monetary policy statement is likely to remain "neutral" and should re-emphasize the need for weaker exchange rate to achieve more balanced growth. With growth still robust, we believe there is room for RBNZ to raise rates earlier than their own forecast – Mar 2020.

- Our recent study on whether RBNZ can afford to remain accommodative for longer (based on our inflation forecast, RBNZ target and RBNZ transmission lag) suggests that RBNZ maybe running slightly behind the curve in tightening - NZ inflation is forecasted to reach 2% median target in about 5 quarters' time while RBNZ's monetary policy transmission lag is about 6 – 8 quarters. However inflation does not appear to be at risk of overshooting and we do not think the RBNZ will move before Mar-2018. Leadership transition at RBNZ due to change of RBNZ Governor from Graeme Wheeler to Grant Spencer (as acting Governor for 6 months before retirement), effective 26 Sep could see monetary policy remain status quo till Mar-2018 unless inflation overshoots upper band of target range of 3% (not our forecast).

- At the last RBNZ meeting (22 Jun), RBNZ kept OCR on hold at record low of 1.75%. Accompanying statement acknowledged the lower economic growth in 1Q but maintained its positive assessment of the outlook, supported by accommodative monetary policy, strong population growth, and high terms of trade. Budget 2017 is also expected to support growth outlook. Statement also reiterated that the jump in inflation was due to higher petrol and food prices and the effects are likely to be temporary and re-emphasized the need for lower NZD to rebalance growth outlook towards the tradables sector. While RBNZ removed the wordings – 5% decline in Twi since Feb is encouraging, it also explained that the recent 3% increase in TWI was due to higher export prices.

- **Latest Fiscal and External Balance Outlook:** Government finances continue to perform well above expectations with OBEGAL showing a surplus of $4.49bn (vs. forecast surplus of $2.94bn) for the 11-months to May 2017. This was due to higher than forecasted corporate and investment tax revenue. The Treasury this variance to reverse in May's accounts.

- In NZ budget (25 May), surplus is forecasted to rise to NZ$7.2bn by 2021, from forecasted $1.6bn (Jun-2017). The government plans to raise tax thresholds, increase accommodation payments and adjust family tax credits. Though the package will cost $6.5bn over 4 years and is expected to eat into budget surpluses, the package is expected to boost spending. The package will result in a modest increase in inflationary pressure and earlier monetary tightening. (Treasury forecasts short term interest rate will rise from 3Q 2018). Net debt is projected to decline to 19.3% of GDP by 2021 from 23.2% this year. A target of reducing debt to 10-15% of GDP by 2025 has also been set.

- 1Q current account deficit widened to $2.8bn (vs. deficit of $1.7bn in 4Q 2016). For the year ending Mar-2017, the current account deficit widened to 3.1% of GDP (vs. 2.7% of GDP). The deterioration was due to record high imports (good deficit widened to levels not seen since 2Q 2008 and came as a surprise as consensus was expecting a surplus of $1bn.

- **Key domestic events and issues to watch:** 2Q unemployment rate, wages (2 Aug); 2-Year inflation expectation (7 Aug); RBNZ meeting (10 Aug); Jul food prices, Mfg PMI (11 Aug); 2Q PPI (17 Aug); Jul trade (24 Aug). GDT auctions on 1 and 15 Aug.

- **Technical Outlook:** NZD traded higher for the month of Jul. High was seen at 0.7558 (27 Jul). Last seen at 0.7510 levels. Underlying momentum on monthly, weekly and daily charts remain bullish. Next resistance at 0.78 (61.8% fibo retracement of 2014 high to 2015 low). Stochastics on weekly and daily charts are in overbought conditions and shows tentative signs of turning lower. Risk of correction. Support at 0.7480 (50% fibo), 0.7350 levels.

JPY: External Risks Delay Descent

Forecast	3Q 2017	4Q 2017	1Q 2018	2Q 2018
USDJPY	112 (115)	115 (117)	115 (117)	117 (119)

Previous forecasts in parenthesis

- **Motivation for the FX View:** The JPY has been among the top performers in Asia, rising 1.9% against the USD since the beginning of Jul. This strength can be attributed to the pullback in UST yields and USD amid the lack of progress on the fiscal front in the US and the possibility of an even more gradual Fed fund rate hike trajectory. In addition, increased political risk in the US as reflected in the failure to move beyond healthcare issues and the engulfing crisis over Russian interference during the presidential elections have weighed on sentiments and have led to safe-haven plays. Consequently, the USDJPY has slipped from a monthly high of 111.49 on 11 Jul to recent low of 110.62 on 24 Jul, a reversal of its earlier upward trajectory.

- Nevertheless, we do not expect this weakness in the USDJPY to persist. While we still do not expect US tax reforms and fiscal spending in the US (Trump reflation trade) anytime soon (more likely to come in sometime in 2H 2018), monetary policy divergence between Japan and its G7 peers should continue to provide the impetus for the USDJPY to climb higher ahead. Unlike the BOJ, the Fed remains on a tightening bias and is on track to hike its short-term policy rate at least once more this year. At the same time, the Fed looks on track to begin its balance sheet reduction. Our house view is that a third rate hike this year is likely to now take place in Dec instead of Sep, while the Fed balance sheet reduction is expected sometime in 4Q. In addition, positive US data (primarily PCE core and US NFP prints) could raise rate hike risks. These should help to support UST yields and widen the yield differentials between the UST and JGB.

- At the same time, the rate hike by Bank of Canada, the signalling by the ECB President that discussions on QE tapering could begin in the fall, and possibility of Bank of England joining in the tightening bias, suggests a divergence in monetary policy with Japan as well. This in turn should see more long-EUR, -GBP and -CAD positions and cross-selling of the JPY. With Japan still on an easing bias in contrast to its G7 peers, the spotlight is now on the JPY as the funding currency of choice, and should put further downside pressure on the JPY.

- Market positioning data also points to further JPY weakness ahead as reflected in recent CFTC data. Speculators have increased the number of short-JPY contracts to 164,338 as of the week of 18 Jul, while long-JPY contracts were at 37,419 with the net short-JPY contracts at 126,919. This was the most since Jan 2014 when net short-JPY contracts were at 128,868. As we had written in our last monthly, we think that there could be room for even more net short-JPY bets ahead, especially with a re-pricing of Fed tightening bias. This could lift UST yields higher with JGB at least holding steady around current levels, leading to further increases in net short-JPY bets and hence, more upside to the USDJPY in the remainder of 2017.

- Underpinning our view for further JPY weakness against the USD, albeit at a more gradual pace, is the central bank's ongoing ultra-loose monetary policy. Unlike its G7 peers, there does not appear to be any end in sight to this easing policy anytime soon. The recent pushback in the dateline for achieving the 2% inflation target to around FY2019, i.e. Apr 2019-Mar 2020, from around FY2018, reflects this. In addition, recent comments and speeches by BOJ policy board members, including its two newest members, Hitoshi Suzuki and Goshi Kataoka, suggest that any discussion on an exit strategy from current policy is premature and that powerful easing policy should continue until the 2% inflation target is achieved. This should be supportive of the USDJPY.

- Though additional easing measures by the BOJ are unnecessary and unlikely for now, such moves cannot be ruled out completely. The BOJ is expected to maintain the status quo with its Quantitative and Qualitative Easing (QQE) with Yield Curve Control. But should inflation fail to gain traction going into 2018, we cannot discount the BOJ unleashing even more easing measures to lift inflation towards the BOJ's 2% target. These easing measures could include cutting interest rate further to -0.3% (from -0.1% currently) and increasing asset purchases of ETFs and J-REITs and other instruments to JPY10tn and JPY6tn.

- Despite the occasional global risk-off episodes, the overall sentiment for Japanese equities is broadly positive. The weak JPY since 2013 has been boosting earnings of Japanese firms and their stocks, and hence the Japanese stock markets. This is reflected in the inflows into Japanese equities so far in 2017. To-date, foreign investors have purchased JPY0.53tn in equities compared to the JPY5.67tn sold off for the whole of 2016. These inflows have put the Nikkei 225 (currently at 20,050) within striking distant of the 2017 high of 20,230 (20 Jun) and not too far off from the multi-year high of 20,868 (24 Jun 2015).

- Further foreign inflows into the equity markets should be positive for the USDJPY given the strong positive correlation between the Nikkei 225 Index and the USDJPY. This is because foreign investors usually hedge their equity purchases against further JPY depreciation by short-selling the JPY. Thus, as global sentiment improves amid low volatility, we can expect even more inflows into Japanese equities and even more upside to the USDJPY. That said, intermittent strength in the JPY due to risk aversion is to be expected, though these should eventually subside, but should not hamper the JPY from depreciating further against the USD.

- Such a risk to the USDJPY could come from concerns about the political future of PM Abe. He and his cabinet are currently polling very lowly among the public that puts a third term in office as well as Abenomics in jeopardy. Still, there is no imminent risk that Abe would lose his job. An impending cabinet reshuffle something in early Aug and a re-focus on Abenomics, particularly the third arrow focusing on structural reforms of the economy, could boost support for PM Abe. Until then, the waning political fortunes of PM Abe increases political uncertainty, driving safe-haven plays. This could lead to some unwinding of short USDJPY positions that could weigh on the pair ahead.

- Given the recent market development and that we now expect a more moderating influence from the USD for at least 3Q, we have once again tweaked our USDJPY forecast. The USDJPY is now expected to still climb higher, albeit more gradually, towards 112-levels (from 115 previously) by end-3Q 2017 and then advancing further to end-2017 at 115 (from 117 previously). We expect the USDJPY to hover around 115 levels by end-1Q 2018 before continuing its upmove towards 117 by end-2Q 2018.

- **Growth and Inflation Outlook:** The Japanese economy looks to continue on its modest recovery path. The BOJ's 2Q Tankan Survey results painted an upbeat manufacturing sector. Sentiments among large manufacturers were the most upbeat since 2014, consistent with the pick-up in production activities. So far in the first two months of 2Q, industrial production has expanded by 6.1% y/y, compared to the 3.8% for 1Q. Similarly, core machine orders (ex-volatile orders) rose by 5.1% y/y in the Apr-May period vs. the contraction of 1.4% in 1Q. The uptick in manufacturing could possible extend beyond 2Q given that the Tankan survey results showed all manufacturers across all industries planning to increase fixed investment by 8.0% for FY2017, and for all industries by 2.9%. Manufacturing activities have largely been driven by the synchronized recovery in exports with exports growing by 10.7% y/y in 2Q vs. 8.2% in 1Q. Meanwhile, strong import growth of 16.2% y/y in 2Q, which nearly doubled that of 1Q, points to a pick-up in domestic demand. The data continues to signal an improving economy and this is reflected in the BOJ's upgrade of its growth projection for FY2017 and FY2018 to 1.8% and 1.4% respectively from 1.6% and 1.3% previously.

- Inflation print for Jun disappointed with the lack of inflationary traction. Headline and core inflation (headline less fresh food prices) held steady at 0.4% y/y from May. Core-core inflation (headline less fresh food & energy prices) was unchanged at 0% for the third consecutive month. The lack of inflationary pressure to date justifies the BOJ policy board to push back the time line for achieving its 2% inflation target (which remained unchanged) at its recent policy meeting on 20 Jul. The 2% inflation target is now expected to be achieved around FY2019, i.e. fiscal year starting Apr 2019 to Mar 2020, instead of around FY2018. This followed the decision by the BOJ to lower its core CPI forecast for FY2017 and FY2018 to 1.1% and 1.5% respectively from 1.4% and 1.7% previously. This is not surprising given the lack of a significant pick-up in wage growth (with growth in base wages, i.e. excluding OT and bonuses, capped below 0.5% for the past 12 months) despite the tightening labour market. This lack of inflationary traction signalled that the ultra-loose monetary policy look set to continue for the foreseeable future.

- **Monetary Policy Forecast:** The BOJ meeting on 20 Jul did not reveal any surprises on the policy front. The BOJ maintained its ultra-easy policy stance as expected, keeping its policy balance (short-term) rate at -0.1% and 10Y JGB yield target at around 0%. It also pledged to maintain its asset purchase program until the 2% inflation target is achieved.

- BOJ governor Kuroda's post-meeting press conference was a reiteration of some of his previous comments, including (1) current policy framework is flexible and will keep the 2% inflation target; (2) hard to make interest rate very negative; (3) more easing is not needed at this time; and (4) persistently continue with powerful easing. Unlike the other G7 central banks that have already begun normalizing rates (Fed and BoC) or planning to withdraw monetary stimulus in due time (ECB and BOE), the BOJ considers it premature to discuss any exit strategy. This serves to highlight the divergent path that the BOJ is taking compared to its peers.

- Additional easing measures by the BOJ is unlikely for now but such moves cannot be ruled out completely. The BOJ is expected to maintain the status quo with its Quantitative and Qualitative Easing (QQE) with Yield Curve Control. But should inflation fail to gain traction going into 2018, we cannot discount the BOJ unleashing even more easing measures to lift inflation towards the BOJ's 2% target. These easing measures could include cutting interest rate further to -0.3% (from -0.1% currently) and increasing asset purchases of ETFs and J-REITs and other instruments to JPY10tn and JPY6tn.

- **Latest Fiscal and External Balance Outlook:** The government has approved an outline for FY2018 budget that government agencies should use as a guideline when submitting their budget request. The government is expected to introduce a JPY4tn budget with investment in key areas including human capital and raising productivity in the services sector. Increases in social security spending is expected to be limited to JPY630bn, while a 10% spending cut from the current FY is targeted in other areas.

- The current account (CA) surplus narrowed for the second consecutive month to JPY1.65tn in May from JPY1.95tn in Apr due to the deficit in the goods and services account of JPY0.07tn in May (Apr: +JPY0.26tn) that partially offset the larger surplus in the income account. The financial account surplus rose in May to JPY2.18tn from JPY1.07tn in Apr due to the larger inflows from direct and portfolio investment, financial derivatives and reserves assets that completely offset the outflows in "other investment". Consequently, the overall balance of payments (BoP) surplus widened to JPY4.37tn in May from JPY2.14tn in Apr.

- **Key domestic events and issues to watch:** Preliminary 2Q GDP will be released on 14 Aug. Before that, we have BOJ policy board member Funo speaking in Sappro on 2 Aug. JGB auctions in Aug: 10-year (1 Aug), 30-year (8 Aug), 5-year (11 Jul), 1-year (16 Aug) and 20-year (22 Aug). A cabinet reshuffle is expected sometime in the first week of Aug to stem the slide in PM Abe's popularity.

- **Technical Outlook:** USDJPY traded 1 way higher in early part of Jul (from 112 levels to high of 114.49) before trading 1-way lower. Pair was last seen at 110.50 levels. Bearish momentum on daily chart remains intact. Key area of support around 110 – 110.30. Beyond this may put the pair down at 108.90 (Jun-207). Resistance at 111.60 (50% fibo), 112.20 (61.8% fibo).

CNY: USD No Longer Threatening?

Forecast	3Q 2017	4Q 2017	1Q 2018	2Q 2018
USDCNY	6.77 (6.80)	6.80 (6.87)	6.81 (6.85)	6.83 (6.85)
USDCNH	6.77 (6.80)	6.80 (6.87)	6.81 (6.85)	6.83 (6.85)

Previous Forecasts in Parenthesis

- **Motivation for the FX View:** The USD has disappointed us yet again, weighed by weak retail sales, wage growth and inflation print as well as the gridlocks faced by the White House in healthcare and concomitant delays in other reforms on the economic agenda. As a result, July was another bullish month for the yuan against the USD. The retreat in the USD was also in tandem with the UST yields. CGB-UST 10y yield spread steadied around 130bps for much of the past month, giving further support to the yuan against the USD. In addition, the emphasis by the Chinese government on deleveraging and reforms in mid-Jul, coupled with a release of pretty solid numbers for June 2Q GDP suggests that China might not need to loosen monetary policy as much as we have originally anticipated. That has probably caused a slump in the CNY 12M NDF points to 1367, at last sight (26 Jul). Taking into consideration the USD weakness, the better-than-expected activity data for Jun and 2Q in China, we have shifted our forecast correspondingly lower towards 6.77 for 3Q though we are still looking for mild upsides towards 6.80 towards the rest of the year, based on seasonality and potential for more USD strength against most Asian currencies as market players position for the next three hikes projected by the Fed for 2018.
- With renewed pledges to deleverage, the CGB-UST 10y yield spread may remain somewhat steady and that could limit the upmove for USDCNY and USDCNH into the end of the year. With the DXY index now around the 93-figure, the greenback seems much less threatening than before. SAFE seems to agree as there are plans to scrap the 20% reserve requirements for financial institutions settling foreign exchange forward yuan positions. Since USD is less threatening than before and China has ample room to meet its growth target for the year after registering a strong 6.9%y/y growth in 1H, PBoC has a lot more room to relax capital controls, allow market forces to drive the yuan whilst maintaining a prudent, neutral monetary policy. Even PBOC had said to “further improve yuan exchange rate mechanism” in a statement and we do not rule out more tweaks to the fixing or trading band that could demonstrate more symbolic commitment towards yuan liberalization. Deleveraging will continue and that could affect liquidity conditions time to time. However, PBOC is likely to stand by with sufficient liquidity injection to support the economy. Combine this with an underlying expectation for further deleveraging could mean more drastic moves will be seen on the longer end of the sovereign curve. The sovereign curve has been bull steepening since

Jun. We do not see short-term rates declining by a lot more while long-term rates could rise modestly.

- The start of the stock connect seems to have attracted quite a bit of inflow. Liquidity management has been rather even and we even saw net OMO withdrawal for 3 out of 5 weeks in Jun before a strong injection in the third week of Jul (CNY 510bn). Even as China places strong emphasis on deleveraging and financial reforms, we do not expect a lot of liquidity tightening ahead of the Party Congress in 2017. The recent removal of Chongqing Communist Party boss, Sun Zhengcai, a strong contender for China's next leadership, for investigation by the Central Commission for Discipline Inspection, paves the way for President Xi's close associate Chen Miner. That has strengthened the power for Xi's second term at the congress. We think growth stability for the second half of the year is still paramount for the leadership transition in the autumn and liquidity conditions will be managed evenly along with CNY. We look for USDCNY to remain within 6.70-6.80 for much of the next few months, barring shocks in the USD.
- **Our monthly Maybank vulnerability score** (using 9 economic and market variables: GDP, Yield, Politics, Current Account, Inflation, Fiscal, Equity Valuation, Population, Reserves) showed a marginal deterioration for China to 4.8 from previous 4.7 (with 1 being the best and 9 being the worst) as its PE valuation worsens relative to peers.
- **Growth and inflation outlook:** Jun data was promising with the Caixin PMI-mfg back in expansion. Firms noted stronger rise in production and new orders. That said, Markit noted that client demand on the whole seems to be subdued and manufacturers have reduced their inventory holdings. Business outlook also edged to year low. The official PMI-mfg that measures the outlook for small and medium sized enterprises seem to suggest the same with the breakdown of the headline for small and medium inching lower to 50.1 and 50.5 respectively from 51.0 and 51.30. Some deterioration was seen in terms of production and new order for medium enterprises. On the other hand, the PMI-mfg for large enterprises improved. Trade numbers also saw improvement with exports growth up 17.3%y/y vs. previous 15.5%. Imports growth at 23.1%y/y from 22.1%. Healthy outward shipments suggest gradual improvement in external demand while domestic demand underpins the imports growth pace.
- GDP came in at a surprisingly strong 6.9%y/y for the second quarter, lifting many growth projections in the private sector for the rest of the year. The release of the growth number was accompanied by strong upside surprise in industrial production, retail sales and to a smaller extent the urban FAI. Retail sales growth quickened to 11.0%y/y from 10.7%, further underscoring the strong household consumption. From the Jun release, output also particularly picked pace in the food, pharmaceutical and general-purpose equipment, telecommunication & computer and cars manufacturing sectors.
- PPI steadied around 5.5%y/y in Jun as metal prices started to firm in recent months. On the other hand, CPI was also unchanged at 1.5%y/y, weighed by the decline in prices of meat and poultry and slower price pressures in fresh fruits. With food and fuel inflation rather anchored, price pressure is likely to remain in check for now.

- **Monetary Policy Forecast:** When PBOC failed to follow through with a hike after the Fed hiked in Jun, we were more convinced that China is unlikely to see much tightening towards the end of the year. Whilst the government has emphasized on less risk taking and more deleveraging, we continue to retain our view that liquidity management will not be as tight as what we have seen in the first half of the year. In fact, liquidity conditions have been managed rather evenly with net injection at a mere CNY20bn and CNY40bn in May and Jun respectively. This was a sharp reduction from the CNY210bn injection recorded for Apr. Interestingly, there is an increasing reliance on 3M Negotiable Certificate of Deposits rather than 7-day reverse repo in recent weeks, indicating that the credit reliance is of a longer tenor compared to the past.
- Recall that PBoC had stated in the (Central Economic Work Conference, 4Q Monetary Report) that monetary policy will be "prudent and neutral". The central bank has been tightening in the first quarter and we expect a more neutral theme in the rest of the year, to ensure a more favourable economic backdrop as the 19th National Congress of the Communist Party of China draws close in autumn. In the meantime, CNY will also be managed using the anti-cyclical adjustment factor, allowing it to strengthen the CNY against the USD as well as other regional peers and major trading partners.
- **Latest Fiscal and External Balance Outlook:** Premier Li Keqiang said at the World Economic Forum in Dalian that China will keep macro policies stable with proactive fiscal policy and prudent monetary policy. Reducing excess capacity is still a focus and China pledges to use more market-oriented measures to lower steel and coal capacity. From the NPC, Finance Minister Xiao Jie announced that budget deficit for the year is retained at -3% of GDP for 2017 though the absolute deficit amount is raised CNY200bn to RMB2.38trn this year. Fiscal expenditure has been rather aggressive in the first four months of the year, compared to past years. We are less confident that the government can maintain this pace of fiscal spending. Government debt is low at 36.7% of GDP, local government debt ceiling is to be raised by 10%. Tax revenue of retail sector rose 25%y/y in 1H according to the State Administration of Taxation.
- Implementation is to speed up with the third batch of MoF Public-Private-Partnership taking 11 months to start compared to 15 months for the first batch. This could boost private investment with less fiscal commitment from the government.
- As of last available data, current account surplus widened to U$18.4bn in 1Q from previous U$11.8bn due to a smaller deficit in services trade and smaller deficit in income outflows. Trade balance saw a narrower trade surplus of U$81.7bn. BOP has been recording outflow via loan, trade credit and currency deposit that amounted to U$116bn in 4Q. Expect this outflow to narrow into 1Q given that China imposed more capital account restrictions for individuals and corporates to remit or invest overseas since the start of the year. FX reserves saw another mild increase in Jun, likely due to valuation to U$3056.8bn from previous U$3053.6bn. Capital outflows seem to have eased for now and with PBOC intervening in the currency markets along with an additional countercyclical adjustment factor to stem

volatility, that could temper capital outflow. Nonetheless, capital outflow could still worsen from the current situation as we look for CH-US yield spread to narrow.

- **Key domestic events and issues to watch:** NBS Mfg PMI due on 31st Jul, Caixin PMI on 1st Aug, foreign reserves on 7th, trade on the 8th, CPI, PPI on 9th, monetary data on 10-15th. Retail sales, FAI, industrial production on 14th. Property prices on 18th followed by FX Net settlement on 20th. Industrial profits on 27th.
- **Technical Outlook:** USDCNH is poised to end this month near the year low of 6.7242. We watch this level, the second attempt to break this level in just two days. A failure to break this level could mean further downside pressure in the USDCNH. If not, this could be a double/triple bottom that could lift USDCNH to rise within the 6.72-6.82 range that we have been eyeing. Support is seen at 6.6840 before the next at 6.6688 and before 6.6420.

KRW: Wild Swings Expected

Forecast	3Q 2017	4Q 2017	1Q 2018	2Q 2018
USDKRW	1150 (--)	1160 (--)	1170 (--)	1180 (--)

No Change to Previous Forecasts

- **Motivation for the FX View:** USDKRW traded a high of 1157 (6 Jul) before the sharp decline to 1110 (27 Jul), driven by broad USD weakness owing to fading hopes of US's monetary and fiscal impulses. Such wild swings are likely to persist given the currency's high-beta nature and its sensitivity to both external and domestic drivers including geopolitical tensions in Korea Peninsula, risk sentiment, US political woes, etc. For the month ahead, we expect 2-way risks to persist and the pair to trade 1100 – 1140 range, with slight bias to the upside. Potential unwinding of global monetary policy (though pace is expected to be gradual) is expected to tighten financial conditions and weigh on sentiment and KRW. BoK's outright verbal intervention (last week) on excessive moves (gains) in currency should also not be overlooked.

- We do not see a strong case for BoK to rush into raising rates at the upcoming meeting (31 Aug) despite the rise in Korea's inflation towards BoK's target level of 2% level this year. This is unlikely to force the hand of BoK to tighten prematurely as inflation has been supply-side driven. Inflationary pressures from the demand side remain soft for now. We expect BoK to keep monetary policy accommodative, with policy rate on hold at record low of 1.25% for this quarter. We acknowledged that BoK Governor Lee did say (13 Jul) that the degree of accommodative policy could decrease, but he also said it will not come before he sees a clearer trend of an economic recovery, and he reiterated that BoK does not respond directly to major countries' monetary policies.

- We **maintain our USDKRW forecast over the forecast horizon and keep the upward trajectory in USDKRW** into the turn of the year as we expect markets to reprice Fed's monetary tightening and Trump's plan on tax reforms and fiscal spending take shape towards end-2017.

- **Downside Risks to Our Outlook:** USDKRW may trade lower our expected range should the case for global policy unwind proceed at an even moderate pace than gradual. This environment should fuel risk-on sentiment and may subject KRW to further gains. KRW could strengthen even further should supplementary budget materializes fast into job creation, further supporting domestic demand.

- **Our monthly Maybank Vulnerability score** (using 9 economic and market variables: GDP, Yield, Politics, Current Account, Inflation, Fiscal, Equity Valuation, Population, Reserves) for S.Korea deteriorated to 7.0 (vs. 6.9 prior), owing to inflation.

- **Growth and Inflation Outlook: 2Q GDP eased to 0.6% q/q (vs. 1.1% in 1Q).** On y/y basis, 2Q GDP eased to 2.7% (vs. 2.9% in 1Q). The **pullback was due to decline in exports (-3% q/q)**, with decreased outbound shipments of transportation equipment and petroleum & chemical products. On the plus points, consumption firmed 2.4% y/y vs. 2.2% in 1Q) and investment spending in plant and equipment/facilities remain strong.

- President Moon has revealed a 5-year economic plan (25 Jul), upgrading its 2017 economic growth projection to 2.8% (from previously forecast of 2.6%). The KRW11tn supplementary budget has also recently been approved and is about 0.7% of GDP. 70% of which will be front-loaded to be deployed for use for this quarter. This is expected to add about 0.2ppts to GDP growth. The supplementary budget is focused on job creation (about 110,000 jobs including 71,000 jobs in the public sector), to support growth (helping domestic demand recover). This should help domestic demand recover further.

- **Headline inflation moderated in Jun to 1.9% y/y (vs. 2% in May),** due to slower increase in transportation component. The uptrend is likely to be sustained at around current levels of 2%, which is also BoK's target CPI for 2016 – 2018. Core inflation also moderated to 1.4% (vs. 1.5% in May) and is expected to stay in the mid-to-upper range of 1%.

- **Monetary Policy Forecast**: We do not see a strong case for BoK to rush into raising rates at the upcoming meeting (31 Aug) despite the rise in Korea's inflation towards BoK's target level of 2% level this year. This is unlikely to force the hand of BoK to tighten prematurely as inflation has been supply-side driven. Inflationary pressures from the demand side remain soft for now. We expect BoK to keep monetary policy accommodative, with policy rate on hold at record low of 1.25% for this quarter. We acknowledged that BoK Governor Lee did say (13 Jul) that the degree of accommodative policy could decrease, but he also said it will not come before he sees a clearer trend of an economic recovery, and he reiterated that BoK does not respond directly to major countries' monetary policies.

- **Latest Fiscal and External Balance Outlook:** Current account surplus widened to US5.94bn in May (vs. US$3.89 in Apr) but on y.y basis, the surplus nearly halved from $10.49bn in May last year. This is due to higher oil imports and plunge in visitor arrival from China

- Korea's sovereign debt is expected to increase to KRW682.4tn by end-2017, from KRW641tn. Government debt now stands at 44.8% of GDP. The rising debt has to do with tax cuts and increasing welfare spending made during former President Lee's era. The National Assembly Budget Office estimates government debt will rise to KRW800tn in 3 years' time.

- **Key domestic events and issues to watch:** S. Korea releases Jul trade, CPI, PMI data (1 Aug); unemployment rate (9 Aug); first-20 days of exports data, PPI (21 Aug); and Jul Industrial Production (31 Aug). BoK meets on 31 Aug.

- **Technical Outlook:** USDKRW traded down sharply from above 1155 level (early-Jul) to a low of 1110 (27 Jul). Last seen at 1121 levels. Bearish momentum on daily chart shows signs of waning while stochastics is showing signs of rising from oversold conditions. Rebound could re-visit 1130 (50, 100 DMAs), 1134 (50% fibo retracement of Jul high to low) and 1140 (61.8% fibo). Key area of support remains at 1105 – 1115 levels. Break below this may see the pair trade towards 1090.

SGD: Still Pressured Lower Despite Current Tailwinds

Forecast	3Q 2017	4Q 2017	1Q 2018	2Q 2018
USDSGD	1.3500 (1.3900)	1.3500 (1.3800)	1.3600 (1.3950)	1.3650 (1.4050)

Previous forecasts in parenthesis

Motivation for the FX View: The upward trajectory of the USDSGD faced another roadblock in Jul. Aside from the lack of fiscal impulse in the US that faded Trump reflation trades, the new drag on the USDSGD is the expected push back in the third rate hike and the start of the Fed balance sheet normalization. Our houses view is now for them to take place in Dec and 4Q17 respectively. This should weigh on the US yields and the USD and slow the pair's climb higher. Unsurprisingly, the SGD is now among the top performers against the USD, rising 1.85% since the start of the month.

- Though the Fed could delay any future monetary action till 4Q, the same cannot be said for the central banks of other developed economies, especially the ECB, BOE and BOC. Already, the BOC has started its tightening cycle with the ECB and BOE likely to join in the party as soon as Sep. This has led to the re-establishment of long-EUR, -GBP and -CAD bets and the unwinding of long-USD positions, keeping a lid on the USDSGD. This together with the ongoing synchronized recovery in exports in the region, possible monetary policy convergence with the US, and the historical low volatility environment as reflected in the equity and FX volatility indices, should spur flows greater flows into emerging market assets, including those in Singapore. This should be supportive of the SGD. Consequently, we have revised downwards our USDSGD forecast to take into account the more moderate USD. We now expect the USDSGD to end 2017 at 1.3500 instead of 1.4200 previously.

- Our underlying assumption remains for the USDSGD to be supported in the next three-six months, underpinned by a moderate rise in UST yields. The rise in UST yields should continue to be underpinned by steady US economic growth, the ongoing normalization of US rates and expectation of Fed's unwinding of its QE. We also cannot discount the possibility that the global reflation trade (possibly in 2H 2018) could re-emerge that could lift UST yields. The rise in UST yields is likely to have a significant impact on the USDSGD, given that the USDSGD is one of the most sensitive currency pair to moves in 10Y UST yields. This rise in UST yields is likely to narrow the yield differentials between the UST and SGS (assuming no change in SGS yields) and result in outflow of funds back to the US, lifting USD and supportive of the USDSGD.

- Apart from the more moderate USD trajectory due to fading Trump reflation trades (now expected to come in only in 2H 2018), the healthy macroeconomic fundamentals of the economy led by the synchronized recovery in exports in the region also plays a part in dampening aggressive upside in the USDSGD for the rest of the year. In addition, the SGD should find support from the government's mildly expansionary fiscal policy, which together with still accommodative monetary policy, its triple-A status and persistent balance of payments surpluses, should be supportive of the SGD and cap USDSGD upside this year.

- We can expect some upside to the SGD when the MAS meets in Oct. For now, our house view remains for a possible adjustment to the current 'neutral' policy stance in Oct to one of a 'mild appreciation bias'. Expected acceleration in core inflation and economic growth momentum should continue to underpin this decision. This should be supportive of the SGD and mitigate the upside risks to the pair that we expect from the rate hike in Dec and the Fed balance sheet normalization in 4Q17. Should MAS maintain its neutral policy bias at its Oct meeting, the USDSGD could climb higher towards the 1.36-levels by year-end. We will continue to monitor incoming data over the next few months for evidence of a pick-up in inflationary pressures that would be supportive of a policy tightening in Oct.

- Taking into account the recent market development, we now expect the USDSGD to end the 3Q at 1.35 and hover at this level till the end of the year (previously 3Q: 1.3900 and 4Q: 1.3800). We expect markets to begin re-pricing US reflation trades in 1H 2018 and should provide the USD with a lift and push the USDSGD higher to 1.3600 and 1.3650 by end-1Q 2018 and -2Q 2018 respectively from 1.3950 and 1.4050 previously.

- **Singapore's monthly Maybank Vulnerability score** (using 9 economic and market variables: GDP, Yield, Politics, Current Account, Inflation, Fiscal, Equity Valuation, Population, Reserves) held steady at 4.4. This should be supportive of the intrinsic value of the SGD. Our model shows that the SGD NEER was last seen 0.91% above the mid-point implied at 1.3698. Upper bound is implied at 1.3426 while lower bound is now at 1.3969.

  Growth and Inflation Outlook: Advanced estimates for GDP showed the economy expanding by 2.5% y/y in 2Q17. If not for the downward revision in 1Q to 2.5% from 2.7%, this pace of growth would have been a moderation. On a q/q seasonally-adjusted basis, GDP rose by 0.4% in 2Q from -1.9% in 1Q, allowing the economy to escape the clutches of a technical recession. Growth in 2Q was supported by manufacturing, which rose 8% y/y, while services growth accelerated 1.7% y/y supported by the transport & storage and business services sectors. Construction remained a drag on the economy, contracting by 5.6% y/y (1Q: -6.1%). Our economic teams expect an upward revision to the services sector to around 2% when the final GDP print for 2Q is released later this month, supported not only by the transport & storage and business services sectors but also by the finance & insurance and wholesale & trade sectors. For the full-year, our economic team is penciling growth of 3.0% and 2.4% for 2017 and 2018 respectively. They also expect the government to upgrade and narrow their GDP growth forecast to 2-3% for 2017 from the current 1-3% when final 2Q GDP print is released.

- Headline inflation softened to 0.5% y/y (May: +1.4%), weighed by a sharp decline in housing & utilities costs (due to fading base effects from the disbursement of service & conservancy charges rebates in May last year). Core inflation also decelerated in Jun to +1.5% y/y (May: +1.6%) on lower services and food inflation. This brought 1H 2017 headline and core inflation to +0.7% and +1.4% y/y respectively. Our economic team continues to expect consumer prices to rise gradually over 2H17, supported by the cyclical recovery as well as planned administrative price increase (water price hike to start in Jul). This gradual pick-up in inflation (both headline and core) in 2H bring 2017 average to 1.2% (MAS forecast 0.5%-1.5%) and 1.6% (MAS forecast 1%-2%) respectively in 2017.

  Monetary Policy Forecast: The MAS has maintained its 'neutral policy' stance since Apr 2016 with the slope of the SGD NEER policy kept at zero percent. There was also no changes to the width of the policy band or the level at which the policy band is centered. The forward guidance that the neutral policy stance is appropriated for "an extended period" remained in place, suggesting a more accommodative policy remains appropriate amid benign inflationary pressures. For now, our house view remains for a possible adjustment in the MAS policy stance at the Oct meeting. We expect the MAS will likely shift to a 'slight appreciation bias', underpinned by potential upside risk to inflation due to the uptick in administrative prices (water, service and conservancy charges) and a cyclical growth recovery.

- Support for a "mild appreciation bias" also comes from our estimates using the Taylor Rule, which showed that a shift in policy stance is appropriate. Our estimates show that the SGD NEER is expected to strengthen ahead and suggests that the current policy parameters could be adjusted at the next policy meeting in Oct. This should temper inflationary pressures that could arise in the next six-to-nine months amid a synchronized recovery in exports in the region and possibility of stronger global growth led by the US.

- The USDSGD traded to a new low for 2017 at 1.3543 (on 27 Jul) – a level not seen since Sep 2016 – amid a pullback in UST and the USD on the Fed's inflation view. Pair has rebounded mildly towards the 1.3590-levels at the point of writing. This oscillation in the USDSGD so far this year has seen the 3-month SOR (3MSOR) touch a 2017 high of 1.02% on 7 Jul before coming off to hover around the 0.8% levels at the point of writing. The 3-month SIBOR (3MSIBOR) though has climbed back above the 1.0% levels and is now hovering around the 1.12% levels currently. The still modest rise in rates suggests that the rise in mortgage rates remains on the slow grind higher. Deposit rates (for 12-month fixed) have also not risen since end-Jan but has remained at 0.33%. This continues to suggest that risks related to interest rate increases affecting financial and economic stability, particularly in interest rate- and property-related sectors, seems limited for now, though the risk could be rising.

- Upward pressure on domestic rates remains, with one more Fed rate hike expected for the remainder of 2017 and Fed balance sheet reduction to begin in 4Q17. US 3MLIBOR continues on its upward trajectory and is currently hovering around 1.31% at the point of writing, just a tad off the new high for 2017 at 1.32%. Ample liquidity has so far kept domestic rates from tracking the US 3MLIBOR higher though, allowing domestic rates to continue with its rather slow grind higher. Consequently, we now expect a more moderate climb in the 3MSIBOR and 3MSOR at 1.16% and 0.94% respectively by end-3Q 2017 (previous: 1.37% and 1.15%). For the full-year, we expect the rates to end 2017 at 1.31% and 1.09% (from 1.61% and 1.39%) respectively.

Latest Fiscal and External Balance Outlook: Operating revenues rose moderately to SGD69.45bn in Mar from SGD68.67bn in Feb, while total expenditure rose to SGD75.07bn in Mar from Feb's SGD71.39bn. This led to a primary deficit of SGD5.62bn in Mar, up from -SGD2.72bn in Feb. Nevertheless, with special transfers, top-ups and net investment income, the overall budget was in a surplus of SGD1.91bn in Mar (Feb: SGD5.18bn).

- The current account surplus widened to SGD19.40bn in 1Q 2017 from SGD18.13bn in 4Q 2016. The larger surplus was attributable to the more moderate deficits in the primary income (1Q: -SGD1.68bn vs. 4Q: -SGD3.74bn) and secondary income (1Q: -SGD3.63bn vs. 4Q: -SGD3.81bn). The financial and capital deficit however narrowed sharply to SGD3.28bn in 1Q17 from 4Q's SGD22.73bn on the back of a sharp drop in portfolio investment outflows of SGD2.90bn (4Q: SGD13.96bn) and an inflow to financial derivative of SGD8.27bn (4Q: +SGD3.37bn). As a result of the smaller deficit in the financial and capital account, the overall balance of payments (BoP) rebounded back into surplus of SGD16.61bn from 4Q's deficit of SGD3.93bn.

- **Key domestic events and issues to watch:** The final GDP for 2Q will be released sometime 18-25 Aug.
- **Technical Outlook:** USDSGD drifted lower for the month of Jul. Last seen at 1.3580 levels. Bearish momentum on monthly, weekly and daily charts remain intact, though bearish momentum on daily chart shows tentative signs of waning while stochastics shows signs of rising from oversold conditions. Chance of rebound possibly towards 1.3620 (23.6% fibo retracement of Jul high to low), 1.3670 (38.2% fibo) and 1.3740 (61.8% fob). Support remains at 1.3540 levels.

MYR: Still Remaining Resilient in a Tight Range

Forecast	3Q 2017	4Q 2017	2Q 2018	2Q 2018
USDMYR	4.2500 (--)	4.2750 (4.3000)	4.3000 (--)	4.2500 (--)

No Change to Previous Forecasts

- **Motivation for the FX View:** We remain positive on the Ringgit outlook given support for fundamentals remain intact as data released over the first two months of 2Q such as industrial production, retail trade and trade data remain positive. Besides, BNM initiatives to broaden and deepen the onshore financial markets remain intact and help to shore up confidence. We interpret these steps as positive development and expect foreign investors' confidence to gradually return. Thus far foreign investors interest in Malaysian equities and bonds have picked up, with data up until July showing inflows.
- Foreigners remained net buyers of Malaysian equities i.e. +MYR0.19b up to 19 July 2017, adding to the +MYR10.8b net buy in 1H 2017. To note however, net foreign flows into the equity market is showing moderating trend over the past few months, from the high of +MYR4.3b in Mar 2017 to +MYR2.6b in Apr 2017, +MYR2.1b in May 2017 and +MYR0.3b in June 2017. Meanwhile, net foreign flows in the Malaysian bond market for Jul 2017 will only be available by the end of first week of Aug 2017. Foreigners turned net sellers in Jun 2017 totaling –MYR0.3b after two months of net buys (May 2017: +MYR10.1b; Apr 2017: +MYR6.8b). Cumulatively, foreigners were net sellers of bonds totaling –MYR20.8b. The next Government bonds maturity is MYR9.5b GII note on 30 Aug 2017. This should not result in major selloff in the bond market and pressures on external reserves as foreign holdings are much lower in GII than in Malaysian Government Securities (MGS) i.e. 7.8% in GII vs 41.2% MGS as at June

2017. The next MGS maturity are in Sep-Oct 2017 totaling MYR27.5b, but the risk of maturity-driven foreign selling in the bond market has dissipated after the large selloffs between Nov 2016-Mar 2017, especially in Mar 2017 where we had the record high net foreign sell of –MYR26.2b, suggesting sizeable "pre-maturity" selloffs in MGS.

- Given improved investors' sentiment, well-managed expectation for Fed rate hike given pricing in of forward guidance this year, less dependence on oil for revenue, and MYR being fundamentally and historically undervalued, we see scope for Ringgit to play catch up with regional peers and extend its gains towards 4.25 levels (vs the USD) for 3Q, before some strength in the USD towards year end potentially supporting the pair at around 4.2750 by end of the year. We have revised our end 2017 forecasts to reflect our concern that there could be some risk of delayed tightening by the Fed and further delays in a US fiscal stimulus.

- We reiterate our **long-standing bias that the Ringgit remains fundamentally undervalued.** Our fair value estimate (which takes into account interest rate differential, inflation differential, current account differential and reflation variables) puts USDMYR at 3.70 levels. We had previously said that Ringgit weakness was temporary and was not a reflection of underlying fundamentals (which remain intact). We believe stability is gradually returning to Ringgit as political/ contingent liability risk subsides, fiscal consolidation gains traction, oil prices continue to stabilize and uncertainty subsides. Solid underlying fundamentals and policies, backed by domestic demand, re-calibrated supportive budget (on a lower oil price assumption suggests flexibility in the fiscal space), relative stability in oil prices though some downside pressure exists, relative attractive yields in the MGS, stabilizing FX reserves to retained imports & short-term debt, accommodative monetary conditions (to support businesses) remain intact and should provide an anchor for MYR stability once short-term noises subside. We believe USDMYR range of 4.20-4.40 is likely to remain relatively sustained for 2017.

- **Positive Development to Deepen Onshore Financial Markets**. According to BNM press release (13 Apr), the Financial Markets Committee (FMC) announced a number of initiatives targeted to promote (1) a fair and effective market, (2) improve bond market liquidity; (3) ease hedging activities and; (4) enhance transparency and market information. All the initiatives under (1) to (3) will take effect on 2 May 2017 (Tue) while enhancement to financial market infrastructure will be implemented on a gradual basis and is expected to be completed over a 12 – 18 month period. In particular on points 2 and 3, the regulated short-selling of securities in wholesale money market will be liberalized to allow all residents to participate in short selling activities. This is to facilitate a more effective avenue for the hedging of interest rate risk exposure as well as to generate more trading activities and liquidity in the secondary government bond market. Eligible securities for short-selling transactions will also be expanded to include Malaysian Government Investment Issue (MGII) with an outstanding nominal amount of at least MYR2bn, on top of Malaysian Government Securities (MGS). The aim is to elevate liquidity in the MGII issue and narrow the pricing gap between MGS and MGII. A consultation paper will be issued for market feedback (by 28 Apr) on this proposed inclusion of MGII for short-selling activities. Registered non-bank entities (including institutional investors, companies) will be allowed to hedge up to 100% of their underlying assets and to manage an additional 25% of FX exposures. This allows registered investors to fully hedge and actively manage their FX exposures including unwinding of hedging positions.

- Total gross external reserves rose to USD99.1b at mid-July 2017 (endJune 2017: USD98.9b), equal to 7.9 months of retained imports and 1.1 times the short-term external debt. Year to date, external reserves rose +4.8% from USD94.6b at end-Dec 2016.

- **Growth and Inflation Outlook:** Index of leading economic indicators rose +1.9% YoY in May 2017 (Apr 2017: +1.3% YoY), implying the real GDP growth momentum is sustained in 2Q 2017 and into 3Q 2017 after the +5.6% YoY expansion in 1Q 2017. Our full-year 2017 real GDP growth forecast is +5.1% currently and we expect the official growth forecast of 4.3%-4.8% to be raised soon. Our Economists had last month upgraded the 2017 real GDP growth forecasts to +5.1% from +4.4% previously (2016: +4.2%) factoring in the 1Q 2017 GDP numbers, and reflecting mainly upward revisions in the growth of manufacturing (to +5.0% from +4.5%), services (to +5.8% from +5.6%) and agriculture (to +7.0% from +1.5%) on the supply side, and the growth of consumer spending (to +6.4% from +5.9%), public consumption (to +5.5% from +2.9%), investment (to +6.7% from +3.9%), exports (to +7.8% from +1.3%) and imports (to +9.7% from +1.5%) of goods and services on the demand side.

- The prospect of better than expected pick up in real GDP growth this year after the slowdown in 2015-2016 adds to the list and sense of easing macro pains experienced in the past 2-3 years, which include the expected corporate earnings recovery after 3 years of "no growth" which triggered net foreign buying in the equity market year-to-date; sustained current account surplus; delivery of fiscal consolidation targets; stabilization and strengthening of MYR; as well as the receding "foreign holding risk" in the bond market.

- The wild card is external trade in view of the uncertainties over the US trade policy under President Trump, especially the risk to US-China trade relation. However, under the current expectation of a moderate pick up in global economic growth and firmer commodity prices, we are looking at relative better trade growth in 2017 i.e. higher growth in exports and imports of goods and services.

- We continue to keep a close tab on key high frequency domestic data, namely the monthly economic indicators such as the indices on industrial production and distributive trade, external trade, money and banking statistics, as well as major commodity output and prices. In addition, our focus is also on the economic trends as well as policy and political developments in the major economies i.e. US, Europe (including UK), China, Japan.

- Headline inflation rate eased for the third month in a row to +3.6% YoY in June 2017 (May 2017: +3.9% YoY; Maybank-KE: +3.6% YoY; Consensus: +3.9% YoY). The trend in headline inflation continued to be dominated by “Transport”, which also decelerated for the third consecutive month (June 2017: +10.5% YoY; May 2017: +13.1% YoY). Meanwhile, core inflation rate which exclude volatile food and energy prices as well as price-controlled/price-subsidised components of the CPI, including fuel prices) was stable at +2.5% YoY (May 2017: +2.6% YoY). Compared with May 2017, headline inflation declined -0.2% MoM while core inflation was unchanged. Expect inflation to moderate further in 2H 2017 In 1H 2017, headline inflation rate accelerated to +4.1% YoY (1H 2016: +2.7% YoY) but core inflation rate eased to +2.5% YoY (1H 2016: +2.9% YoY). We reiterate our view that the current trend in inflation is in line with our assessment that headline inflation has peaked in Mar 2017 and the outlook is for inflation to moderate further in 2H 2017 to average 3.0%- 3.5% YoY. Hence, we maintain our 2017 and 2018 headline inflation rate forecasts of 3.5%-4.0% (official 2017: 3.0%-4.0%; 2016: +2.1%) and 2.0%- 2.5% respectively. This expectation reflects the view that the current “cost-push” headline inflation – largely due to the impact of the earlier surge in crude oil price on the domestic fuel prices which is a key element of the CPI’s “Transport” component - will taper as “demand-pull” and “wage-driven” inflationary pressures are contained as suggested by the relatively stable core inflation rate.

- Our economists’ maintain the call that the Overnight Policy Rate (OPR) will be kept at 3.00% p.a. as the current trend in inflation is consistent with BNM’s view of moderating headline inflation in 2H 2017, while core inflation rate is contained. Together with the pickup in real GDP growth, MYR that has stabilised and strengthened in recent months, and gradual monetary policy normalization by US Fed, we see little motivation for BNM to alter current monetary policy stance.

- **Monetary Policy Forecast:** BNM kept the Overnight Policy Rate (OPR) at 3.00% at its MPC meeting on 13 Jul 2017. The Monetary Policy Statement (MPS) reflects confidence of a better growth prospect in 2017 with inflation expected to moderate in 2H 2017. Together with MYR having stabilised and strengthened, there is no pressure for BNM to alter course, hence our view of OPR staying at 3.00% this year.

- The MPS essentially suggests the Monetary Policy Committee’s (MPC) confidence of a better growth prospect in 2017 as expansion in domestic economy is supported by favourable external demand. BNM is keeping its monetary policy stance to remain accommodative and supportive of the domestic economy which picked up +5.6% YoY in 1Q 2017. The momentum is expected to be sustained in 2H 2017 amid the synchronized pick up in global economic activities that is positive for Malaysia’s exports in addition to the steady domestic demand driven by continued wage and employment growth as well as the implementation of new and on-going investment projects together with capacity expansion in manufacturing and services sectors.

- Notwithstanding the potential upside in growth, BNM maintained its view that headline inflation will moderate in 2H 2017 (Jan-May 2017: +4.2% YoY), reflecting the waning effect of “cost-push” factors. Core inflation will be sustained by robust domestic demand but to remain contained for the rest of the year.

- No change in our view of OPR staying at 3.00% this year. Overall, we see no motivation for BNM to alter current monetary policy stance this year since growth momentum is intact as per latest statistics on industrial production, external trade and leading indicators, receding inflationary pressures with the slowing headline and the stabilisation and strengthening of MYR. A key area for caution is the uncertainty on external front arising from the emerging prospect of synchronised monetary policy normalisation by major central banks amid current low financial market volatility.

- **Latest Fiscal and External Balance Outlook:** Themed “Accelerating Growth, Ensuring Fiscal Prudence, Enhancing Wellbeing of People”, Budget 2017 maintains commitment to fiscal discipline and consolidation; supports domestic demand via corporate income tax rate cut, incentives for tourism, SMEs, exports and digital economy, and infrastructure investment; and focuses on the wellbeing of the low-and middle-income groups by addressing the issues of inclusivity, equality, cost of living and affordable housing.

- Budget deficit target for 2017 is set at -3.0% of GDP, sustaining the policy of fiscal consolidation since 2010. This year’s aim of -3.1% of GDP is maintained and achievable. Based on monthly data, we estimated budget deficit in Jan-Aug 2016 was -3.9% of GDP as the deficit of -5.6% of GDP in 1H 2016 turned into an estimated surplus of +1.2% of GDP in July-Aug 2016.

- We expect the fiscal deficit to remain flat at 3.1% of GDP, as government spending is likely to pick up (as we enter the election campaign).

- **Key domestic events and issues to watch:** BNM policy decision (6-7 Sep); Trade data (4 Aug); FX reserves (7, 22 Aug); Industrial Production (10 Aug); GDP 2Q (18 Aug); CPI (23 Aug).

- **Technical Outlook:** USDMYR traded a relatively subdued range of 4.2733 – 4.3043 for the month of Jul. Last seen at 4.2790 levels. Bearish momentum on monthly chart remains intact but lacks conviction on weekly and daily charts. Bias to lean against strength. Resistance at 4.2960 (23.6% fibo retracement of Apr high to Jun low) before 4.3244 (38.2% fibo). Immediate support at 4.27 before 4.25 levels.

IDR: Resilient Amid External Headwinds

Forecast	3Q 2017	4Q 2017	1Q 2018	2Q 2018
USDIDR	13350 (13400)	13400 (13450)	13450 (13500)	13450 (13500)

Previous forecasts in parenthesis

- **Motivation for the FX View:** IDR has been relatively resilient among the ASEAN FX. It has been oscillating within a tight 13290-13450 range in Jul as it has in prior months. The healthy macroeconomic fundamentals, including improving current account deficit and ongoing reforms, have helped to keep the IDR stable amid external headwinds. Rising yields in the advanced economies have led to a slowdown in foreign inflows to Indonesian assets in the month. So far in Jul, foreign investors have sold off USD0.82bn of equities compared to USD0.32bn sold for the whole of Jun. Flows to government debt have also slowed with just IDR03.7tn purchased month-to-date vs. IDR14.4tn purchased for the whole of Jun. Not surprisingly then that the IDR has risen by just 0.3% against the USD since the beginning of Jul despite a retracement in UST yields and USD.

- Even though growth has underperformed some of its regional peers, real GDP is expected to improve and expand by at least 5% this year. Support for growth will likely come from the 15 reform/stimulus packages introduced so far that should help to cut red tape and liberalize rules that have been a drag on the economy. In addition, the current account deficit is improving with 1Q 2017 deficit at 0.99% of GDP. Though this could rise to 1.9% of GDP in 2Q, this pace is still an improvement over the deficit of 2.2% in 2Q last year.

- Meanwhile, the government's efforts to rein in the budget deficit by cutting unnecessary expenditure last year and the successful implementation of the tax amnesty program that have increased government revenue have provided slightly more fiscal space to the government in 2017 to push forward with its ambitious infrastructure building programme. The government has committed USD400bn for infrastructure building that should not only lift potential growth but the IDR as well.

- We continue to expect some slowdown in inflows to Indonesian debt, but not a complete reversal of flows, as IDR carry trades remain favourable for now. IDR has generated volatility-adjusted carry trade returns of 6.5% so far in Jul compared to around 3.7% in Jun. The upgrade to investment grade by S&P and Fitch's affirmation of its current rating status are supportive of IDR carry trade. We expect the IDR to hover around current levels as USD strength moderates due to the lack of fiscal (with the focus on reforming healthcare then the economy) and monetary (given the recent more dovish FOMC) impulse.

- Thus, healthy economic fundamentals, low volatility, cyclical growth recovery, fading global growth conditions and relatively easy financial conditions should continue to favour IDR as a carry currency. This should cap USDIDR upside for the remainder of the year. There have been market whispers suggesting that official agents have been in the market intermittently to curb IDR strength above the 13300 levels so far this year to smooth out volatility in the IDR and to ensure that the country's competitiveness is maintained. Thus, we can expect to see the pair supported around the 13300 levels for the foreseeable future.

- There is the risk that narrowing yield differentials in favour of the advanced economies, including the US and EU, could spur some outflows from Indonesian assets. We expect the Fed to hike its short-term fund rate by 25bp at least once more in Dec and the normalization of the Fed's balance sheet to begin sometime in 4Q (our house view). Meanwhile, the ECB will begin to discuss its QE tapering sometime in the fall. In addition, Canada has already begun the process of normalizing rate with its recent rate hike, while the UK is likely to follow suit as soon as it can. Higher returns elsewhere then could see a flow reversal from Indonesian assets back to the advanced economies, limiting the attractiveness of the IDR as a carry currency and keep the USDIDR elevated.

- Accordingly, we tweaked our USDIDR forecast to expect the USDIDR to end 2017 at 13350 and then climb higher to 13400 by the end of 2017. The pair's climb is likely to be extended into 2018, hovering around the 13450 levels in 1H 2018.

- **Maybank vulnerability score** (using 9 economic and market variables: GDP, Yield, Politics, Current Account, Inflation, Fiscal, Equity Valuation, Population, Reserves) for Indonesia was unchanged at 5.3. This should be supportive of the intrinsic value of the IDR.

- **Growth and Inflation Outlook:** 2Q17 GDP should be released sometime in the first week of Aug. BI remains optimistic that the economy would improve in 2Q underpinned by healthy external demand and private consumption. The central bank expects growth of about 5.1% in 2Q compared to market expectations of 5.07%. This is despite a hiccup in motor vehicle and motorcycle sale in 2Q. Both motor vehicle and motorcycle sales contracted by 5.7% and 8.9% y/y in 2Q, suggesting weaker private consumer spending. Still, the continued improvement in FDI to USD8.2bn in 2Q 2017 from USD2.76bn in 1Q on the back of improving investment climate especially in the wake of S&P's upgrade of Indonesia's credit rating to investment grade. The synchronized export recovery in the region remains intact though some slowdown has arisen. External demand for exports expanded by just 7.8% y/y vs. 1Q's 21.1% gain. Similarly, import growth moderated to 4.9% y/y in 2Q from 14.6% in 1Q. Meanwhile, the government's push ahead to implement President Jokowi's USD400bn infrastructure programme should not only bolster growth in the near term but also potential growth. For the full-year, government continues to expect full-year growth to come in at 5.3% in 2017, while BI continues to see growth forecast range is 5.1-5.2% as more reasonable. Our economic team's growth outlook of 5.1% for 2017 is more in line with that of BI.

- For the third consecutive month, headline inflation has been hovering above the 4.0% levels. Headline inflation rose by 4.37% y/y in Jun, up from 4.17% and 4.33% in Apr and May respectively. Though food price inflation slowed by 2.43% y/y (due to better food supply), the climb in housing and transport costs (by 6.18% and 5.8% y/y respectively in Jun) were the main culprits for the uptick in inflation. Core inflation continued to moderate for the fourth straight money, rising by 3.13% y/y from May's 3.20%. The uptick in government-administered prices, particularly electricity tariff, as well as the expected removal of fuel subsidies in 2H 2017, together with the weaker domestic currency, should continue to put upside pressure on consumer prices. Our economic team is still expecting headline inflation to average 4.26% in 2017. The central bank though now expects inflation to come in around or even below 4.0% in 2017 from above 4% previously.

- **Monetary Policy Forecast:** The BI has kept its current policy stance steady for the ninth consecutive meeting. The key 7-day reverse repo rate left unchanged at 4.75%, while both the lending facility and deposit facility rates were maintained at 5.5% and 4.00% respectively. This kept the interest rate corridor steady at 75bp on either side of the policy rate. The status quo has been maintained so far to anchor inflationary expectations, support growth momentum and ensure IDR stability. The front-loading of rate cuts (amounting to 150bp) in 2016 has provided BI with the monetary space to hold its benchmark rate steady amid further US Fed rate hikes and balance-sheet reduction, and threats of protectionism. For now, BI is unlikely to ease policy to lower lending cost and boosting growth given existing concerns about inflation arising from government-controlled prices, which has accelerated by 10.64% y/y in Jun from 9.14% y/y in May. Instead, the central bank is expected to remain vigilant for the remainder of the year to keep inflationary pressures in check. Our economic team believes that the BI will use macroeconomic-prudential policies to boost growth rather than the policy rate and keep the policy rate on hold for the rest of the year and in 2018.

- **Latest Fiscal and External Balance Outlook:** The House of Representatives have approved the revised budget for 2017 that widens the budget deficit to 2.92% of GDP. Though this is just a tad off the 3% mandated ceiling, the Finance Minister Sri Mulyani does not expect this ceiling to be breached as realized spending tends to reach around 95-97% only. The previous estimate for the deficit was 2.4%. The GDP, IDR vs. USD, inflation and oil prices assumptions were revised lower to 5.1%, 13,300, 4% and USD45/bbl respectively (previously 5.2%, 13,400, 4.3% and USD48/bbl).

- The current account deficit (CAD) rose mildly to USD2.40bn in 1Q 2017 or 0.99% of GDP (4Q: -USD2.10bn or 0.9% of GDP) after slipping lower in 4Q 2016 to USD2.10bn. This mild deterioration was due to the larger deficit in the primary income account (1Q; -USD7.15bn vs. 4Q: -USD6.14bn) and smaller surplus in the secondary account (1Q; +USD0.78bn vs. 4Q: +USD0.93bn) that more than off the slight improvement in the goods and services account of USD4.23bn (4Q: USD3.11bn). The overall balance of payments surplus was little changed at USD4.51bn. The BI expects the BoP to remain in a surplus in 2017 but to moderate to USD8-9bn from USD12bn in 2016. This narrowing in the BoP surplus is due to declining capital and financial account and deficits in the current account (expected around 1.8-1.9% of GDP). For 2017, our economic team expects the CAD deteriorate to 1.15% of GDP due to greater import of capital goods to support the government's infrastructure programme, in line with the BI's outlook for 2017.

- **Key domestic events and issues to watch**: 2Q GDP will be released sometime 4-7 Aug. BI will meet on 22 Aug to decide on monetary policy on 22 Aug.

- **Technical Outlook:** USDIDR traded a range of 13290 – 13420 for month of Jul. Last seen at 13325 levels. Bearish momentum on daily chart shows signs of waning while stochastics shows signs of rising. Next resistance at 13350 (21 DMA, 50% fibo retracement of Jun low to Jul high), 13365 (38.2% fibo), 13385 (23.6% fibo). Support at 13307 (76.4% fibo), 13270 (Jun low).

PHP: Narrowing Yield Differentials, Current Account Deficits & Conflicts To Weigh

Forecast	2Q 2017	3Q 2017	4Q 2017	1Q 2018
USDPHP	50.80 (50.30)	50.90 (50.50)	50.90 (50.70)	50.70 (--)

Previous forecasts in parenthesis

- **Motivation for the FX View:** The PHP was the worst performer among ASEAN FX so far in Jul. The PHP has weakened by about 0.2% against the USD month-to-date, though this was off the 1.2% drop in Jun. The USDPHP has been in large part tracking the moves in global bond yields. Tightening financial conditions as the central banks of the advanced economies shift towards normalizing their monetary policy is weighing on risk sentiments and asset prices (raising the risk of portfolio outflows). It also did not help that there appears to be no end in sight yet to the Marawi conflict on Mindanao Island where martial law has been extended to the end of 2017, weighing on sentiments as well. The search for higher returns elsewhere, particularly in the advanced economies, and the Marawi conflict put downside pressure on the PHP and keep the USDPHP supported above the 50-figure.

- Though the lack of fiscal and monetary impulse from the US is likely to dampen the acceleration in UST yields and moderate USD strength in the near term, a rebound in PHP is still not yet in the cards. This is because the PHP continues to be weighed by both domestic and external concerns that are not easily offset by the moderation in USD.

- Domestically, there remains ongoing concerns about the President's anti-drug policy as well as the extension of martial law in Mindanao that have left some foreign investors sitting on the sidelines. Investment decisions are likely to be delayed until there is greater clarity on the policy front. Net FDI inflows have slowed as a result of these policy uncertainties. Net FDI inflows amounted to USD1.56bn in 1Q17, a deceleration from 4Q16's USD2.08bn. As we had previously cautioned, there is a need for a more nuanced dissipation of these risks before an improvement in the PHP can be realized.

- While indiscriminate killings are still being reported, there are signs that the campaign against illegal drugs is slowing. Similarly, martial law appears contained within Mindanao alone and there does not appear to be any danger of it being extended to other parts of the Philippines for now, even though martial law there has been extended to the end of the year. This should allay foreign investor concerns and could eventually lead to further foreign inflows into the Philippine assets and be supportive of the PHP. However, should martial law be extended country-wide, the USDPHP could climb higher by at least 5% from current levels in the lead-up to the imposition of martial law as suggested by our estimation of the THB moves during the recent martial law episode in Thailand.

- Just as important, the downside risk to the PHP is accentuated by its deteriorating current account. Recent data showed the current account deteriorated to a deficit in 1Q 2017 of -0.4% of GDP in 1Q 2017, narrowing from 4Q's -1.2% of GDP. This was only the third time since 1Q 2012 that the current account has slipped into a deficit on a quarterly basis. The weaker export growth and stronger import expansion - indicative of healthy domestic demand - in the past two quarters led the shift in the current account to a deficit. The slippage in the current account is expected to extend beyond 1Q. In fact, the BSP expects a current account deficit of USD600mn in 2017 vs. a surplus of USD800 projected earlier. The BSP is now expecting the deficit to widen to USD1.6bn in 2018. The deterioration in the current account should weigh on the PHP beyond 2017.

- There is also the risk that UST yields could move higher in 4Q, narrowing yield differentials in favour of the US and exaggerate portfolio outflows. Our house view is now for another 25bp hike in the Fed fund rate by Dec and the normalization of the Fed's balance sheet to take place sometime in 4Q. Taken together, these could lift UST yields higher in 4Q and bolster the USD. Meanwhile, risk of a re-pricing of EU debt in anticipation of the ECB QE tapering discussion sometime in the fall could lift yields there higher. In addition, Canada has already begun the process of normalizing rate with its recent rate hike, while the UK is likely to follow suit as soon as it can. Higher returns elsewhere then could see an exit from Philippine assets and weigh on the PHP with the USDPHP possibly rising higher from current levels to 50.80 by end-3Q and then to 50.90 by end-2017.

- In the longer term though, we could see more inflows into the Philippines equity market. This is because valuations in the Philippines have fallen after the sell-off in the equity market between Aug 2016 and Mar 2017. According to our estimates using the Cyclical Adjusted

P/E (CAPE) ratio, equities are now relatively cheaper (as reflected by estimated P/E ratios minus their 5-year average P/E ratios) compared to its peers and this could eventually attract foreign inflows. We are already seeing portfolio inflows to Philippine equities where foreign investors have purchased around USD40mn so far in Jul. This inflow though pales in comparison to the USD386mn of equities purchased for the whole of Jun. Still, further inflows should go some ways to mitigating some of the downside risks to the PHP and be supportive of the PHP in 2Q 2018. We look for the USDPHP to taper off as such to around 50.70 by end-2Q 2018 after ending 1Q at 50.90.

- Our economic team continues to expect the BSP to be the first in the region to normalize its benchmark policy rate by the end of the year. The expected 25bp hike in policy rate should help to prevent the economy from overheating and anchor inflationary expectations within the BSP's comfort zone of 2-4%. Some support for the PHP is likely to when the first phase of the tax reform program is put in place by the end of the year but we expect the impact on the PHP to be temporary. This is because we believe that the tax reform has mostly been priced in already when the bill cleared the House of Representatives at end-May. Thus, the 25bp lift to short-term rates and the tax reforms are unlikely to be a panacea for its current currency woes.

- We have adjusted our USDPHP forecast to reflect the rising near-term risks to the PHP accordingly. We now expect the USDPHP to climb higher to 50.80 and 50.90 by end-3Q and end-2017. The USDPHP should continue to hover around 50.90 levels in 1Q 2018 before easing off to end 2Q 2017 around 50.70.

- Our monthly **Maybank vulnerability score** (using 9 economic and market variables: GDP, Yield, Politics, Current Account, Inflation, Fiscal, Equity Valuation, was unchanged at 5.0. This should be supportive of the intrinsic value of the PHP.

- **Growth and Inflation Outlook:** The pace of economic acceleration should continue to slow into 2Q17 as it did in 1Q where growth eased to 6.4% from 6.6% in 4Q 201. According to Economic Planning Secretary Pernia, the economy is likely to have expanded by 6.4% in 2Q – the same pace as in 1Q – due to base effects. The economy should continue to be supported by healthy overseas remittances, which rebounded by 5.5% y/y in May after slipping 5.9% in Apr. In the first five months of 2017, remittances has risen by 4.5% y/y, an improvement over the first four months of the year but still off the 5% pace seen in the whole of 2016. This in turn should be supportive of consumer spending, which is likely to remain healthy in 2Q, extending the gains in 1Q amid a tight labour market and rising wages. Meanwhile, the synchronized export recovery in the region continues with exports still rising showing double digits gains in May of 13.7% y/y, though this was still off the pace set in Mar and Apr. Nevertheless, export growth remains solid, expanding by 16.3% y/y in the first five months of 2017 and is on track to register its first expansion after contracting in both 2015 and 2016. Recent FDI data is also pointing to an improvement in sentiments that could continue to support growth ahead. Net FDI inflows were the largest in a year at

USD0.87bn in Apr, up from USD0.37bn and USD0.51bn in Feb and Mar. Year-to-date, net FDI inflows amounted to USD2.43bn. The government thus remains optimistic that the growth target of 6.5-7.5% for 2017 can be achieved. Our economic team though is similarly positive on growth prospects of the economy but expects real GDP to come in below the government's forecast range at 6.4% for 2017.

- After rising at an above-3% pace for the past three months, headline inflation moderated slightly to 2.8% y/y in Jun on broad moderation across most groups, particularly housing & utilities (Jun: 2.1% vs. May: 3.6%) and transport (Jun: 2.4% vs. May: 2.7%). Core inflation (headline inflation less selected food items and energy prices) eased for the second straight month, rising by 2.6% y/y in Jun compared to 2.9% in May. For 2Q17, headline and core inflation rose by 3.1% and 2.8% respectively compared to 3.2% and 2.7% in 1Q. For 1H 2017, headline and core inflation was 3.1% y/y and 2.8% respectively. Our economic team maintains its 2017 and 2018 headline inflation forecasts at 3.3% and 3.5% respectively prices to reflect risks from higher food prices, possible demand-side pressure from strong labour market, stable employment rate and robust wage growth, and sustainable growth spurred by the government's infrastructure spending.

- **Monetary Policy Forecast:** The BSP has left its key policy rate unchanged at 3.0% for the past 9 meetings. There was also no change to the overnight lending rate and overnight deposit rate at 3.5% and 2.5% respectively to keep the corridor symmetrical on either side of the policy rate by 50bp. Recent comments from the BSP suggest that the central bank is in no hurry to adjust its key policy rate. However, our economic team remains firm its expectations that the BSP will be the first central bank in the region to hike rates in 2017 given the outperformance of the economy. The economy has been expanding at a healthy pace above 6%, while inflation continues to accelerate close to the upper bound of the government's comfort zone for inflation. The team expects a single 25bp rate hike in 2017 towards the end of the year as inflation risks remains to the upside, coupled with pressures on the current account balance and the PHP. This modest rate adjustment should ensure that real interest rate remain positive, though we doubt that this would be sufficient to ease downside pressure on the PHP.

- **Latest Fiscal and External Balance Outlook:** In his second State of the Nation address, President Duterte sought Congress' acquiescence for the proposed PHP3.77tn budget for 2018 to bolster growth by 7-8%. The budget plan has projected revenue of PHP2.84tn, a 17% increase over 2017, even though lower collection of personal income tax is expected. This shortfall though is expected to be offset by the new tax measures (when it passes), namely excise tax on petroleum and VAT, which should yield PHP133.8bn in revenues. Expenditure, while not reported, should remain high due to infrastructure spending and should result in the deficit remaining around the 3.0% of GDP level until 2020. According to the government, 80% of this shortfall will be sourced domestically, hence minimizing foreign currency risks.

- The balance of payments (BoP) deficit widened to USD0.57bn in Jun, a jump over May's deficit of USD0.06bn. Detailed breakdown of the components of the BoP is still not available for now but we can infer from this slippage that both the current account and financial account balances continued to deteriorate in Jun. The main culprits of this deficit are likely the merchandised goods account deficit and the narrower surplus in the income account. As for the possible financial account deficit, this could be due to portfolio outflows in the month. For 2Q, the overall BoP surplus registered a surplus of USD0.29bn, a rebound from 1Q's deficit of USD0.99bn, saved by the large BoP surplus in Apr (+USD0.92bn). Still, this surplus is likely to be short-lived as exports, remittances and investment flows could slow. The BSP continues to expect the first BoP deficit in 15 years of USD600mn for 2017, and which is expected to widen to USD1.6bn in 2018.

- **Key domestic events and issues to watch:** BSP meets to decide on monetary policy on 10 Aug, while 2Q17 GDP will be released on 17 Aug. The Congress will begin deliberation on the 2018 Budget at the committee level on 1 Aug and the committee's approval should come by late Aug.

- **Technical Outlook:** USDPHP traded fresh multi-year high of 50.95 (11 Jul) before easing off. Last seen at 50.50 levels. Bearish momentum on daily chart remains intact. Next support at 50.20 (50 DMA), 49.90 (200 DMA). Interim resistance at 51-levels.

THB: Lifted By Near-Term Flows

Forecast	3Q 2017	4Q 2017	1Q 2018	2Q 2018
USDTHB	33.50 (34.50)	34.00 (35.00)	34.00 (35.30)	34.30 (35.80)

Previous forecasts in parenthesis

- **Motivation for the FX View:** The THB continues to be one of the outperformers among ASEAN FX in Jul, helped by not just by the lack of fiscal impulse in the US but also the possibility of a delay in further monetary tightening in the US that has weighed on UST yields and USD. This suggests that gains in the USD are likely to be even more moderate. In addition, the search for higher returns should continue to benefit Thai assets and should help to keep the THB supported ahead. So far in Jul, the THB has risen by 0.6% against the USD. Given this recent development, we now expect the THB to strengthen even more at least in 3Q 2017, though our overall bearish outlook for the THB thereafter is maintained.

- In the next three months at least, positive real yields, strong inflows into government debt and current account surpluses should continue to be supportive of the THB. The widening of real yield differentials between the 10Y UST and Thai government bond should see further inflows into Thai government debt in search of higher returns and lift the THB higher. Relative low foreign ownership in Thailand at 15%

(compared to Indonesia at 38% as of end-Mar 2017) suggests that there is room for even more foreign ownership of Thai assets. This continues to make Thai bonds more attractive than Indonesian ones, and continue to provide support for the THB

- Just as important, the persistent current account surplus should backstop any aggressive THB moves lower. With the exception of Singapore, which historically has persistent and high current account surpluses, Thailand has seen its current account surplus balloon to more than 10% of GDP since 2014. In contrast, the current account surpluses of both Malaysia and Philippines are coming off, while Indonesia continues to see persistent current account deficits. Note though that the current account surplus has been narrowing since Feb and further narrowing could impact investor sentiments and limit upside to the THB.

- The recent tantrum ahead of the FOMC meeting on 26 Jul saw foreign investors selling Thai government debt in anticipation of the Fed signaling further tightening bias. Foreign investors sold THB7.29bn of debt month-to-date, a reversal of the THB15.80bn inflow in Jun. However, the Fed signaling a slightly more dovish outlook on inflation has led to a return of foreign investors to Thailand with USD5.49bn in government debt purchased the day after the FOMC decision on 27 Jul (latest data available). This inflow has been supportive of the THB.

- Nevertheless, we remain bearish on the THB view on our continued expectations that the political situation in Thailand could deteriorate towards the end of the year. The importance of the political environment cannot be understated. Our study using VAR decomposition analysis (which shows the percentage of the forecast variance due to each endogenous variable) highlighted the political environment as the most important factor impacting the USDTHB. For now, the current political calm in the kingdom is providing the impetus for an economic growth recovery and investment inflows, providing support for the THB moves below the 34-levels. However, political sentiments are likely to deteriorate as the election schedule becomes clearer towards the end of the year.

- The political calm and stability is expected to extend to the funeral of the late King HM Bhumibol, which is expected sometime in Nov, and the coronation of HM King Maha Vajiralongkorn, which should follow soon after. Once these ceremonies are concluded and the election scheduled revealed, simmering tensions are likely to resurface. The focus of this tension is the continued dominant role of the military (and the elites) in the political arena to the exclusion of nearly everyone else. Of import is the new constitution which gives the military the power to appoint 250 members of the new Senate in the first five years after the first parliament convenes. In addition, the new constitution allows for the appointment of a non-elected PM to head the government especially in a divided lower house of parliament. These powers would allow the military and its allies to dominate the political arena long after civilian rule has been reinstated. Consequently, political temperature could flare in the run up to the general elections, expected sometime mid-2018. Political uncertainty ahead of the general elections could keep foreign investors on the sidelines until there is clarity on the political front. This could weigh on THB sentiments and support the USDTHB around the 34-handle by the end of the year.

- Domestic political risk aside, there is a risk that market is underpricing US Fed tightening bias. Market is currently not pricing any further rate hike in 2017. Our house view remains for a rate hike in 2017, though this should now come in Dec instead of Sep as we had penciled earlier. In addition, the normalization of Fed balance sheet is expected to begin sometime in 4Q 2017 and this could lift UST yields and support the USD. Meanwhile, there is also a risk of a re-pricing of EU debt in anticipation of the ECB QE tapering discussion sometime in the fall could lift yields there higher. In addition, Canada has already begun the process of normalizing rate with its recent rate hike, while the UK is likely to follow suit as soon as it can. Higher returns elsewhere then could see outflows from Thai assets and weigh on the THB.

- Accordingly, we have adjusted our USDTHB forecast to reflect the even softer USD trajectory resulting from lack of US fiscal and monetary impulse. We now expect the USDTHB to end 3Q17 at 33.50 before climbing higher to hover around 34.00 at end-4Q17. The USDTHB should then head higher to 34.30 at 2Q 2018 from 34.00 at end-1Q on political concerns.

- **Our Maybank vulnerability score** (using 9 economic and market variables: GDP, Yield, Politics, Current Account, Inflation, Fiscal, Equity Valuation, Population, Reserves) for Thailand held steady at 4.7. This should be supportive of the intrinsic value of the THB.

- **Growth and Inflation Outlook:** The economy is poised for a stronger showing in both 2017 and 2018 led by a broad-based expansion in exports. This is not surprising given the synchronized recovery in exports in the region. Recent customs trade data showed that exports rose by 11.8% y/y in Jun while imports climbed 13.5% y/y – marking the second straight month of double-digit growth. Other segments of the economy though remain on the modest recovery path as reflected in recent high frequency data. Private consumption, business sentiments and consumer confidence have all picked up by 2.3%, 5.2% and 4.7% y/y in May, signaling healthy domestic demand. Our economic team maintains its optimistic economic outlook for 2017. The team expects improvement in consumption spending and exports to reinforce the higher public investment and tourist arrivals. Full-year growth is expected to expand by 4.0% for 2017, an above-consensus forecast. Similarly, the BoT has lifted their full-year GDP forecast, penciling in growth of 3.5% and 3.7% for both 2017 and 2018 respectively from 3.4% and 3.6%.

- Disinflationary pressures continued into Jun with headline inflation falling by 0.05% y/y in Jun from -0.04% in May. Consumer prices were weighed by the continued fall in food prices (Jun: -0.7% vs. May: -1.38%) and the more moderate increase in transport cost (Jun: +0.03% vs. May: +1.26%). Core inflation continued to decelerate, rising by +0.45% y/y in Jun from +0.46% in May. For 1H 2017, headline inflation was up 0.7% y/y, well below the BoT's target of 1-4%. Despite the lack of traction in inflation so far, our economic team expects inflationary pressures to return later this year on the back of low base effects, higher energy/fuel prices, improving domestic demand amid a weaker THB. They continue to expect inflation to average 2.5% in 2017, even though the BoT has revised its forecast for 2017 and 2018 lower to 0.8% and 1.6% (from 1.2% and 1.9% previously) respectively.

- **Monetary Policy Forecast:** The BoT has maintained the status quo on monetary policy since 29 Apr 2015, which was when the benchmark interest rate was last cut by 25bp to 1.50%. The last time the policy rate was even lower than this was during the Great Financial Crisis in 2009-10 when the rate lowered to 1.25%. At its last meeting on 5 Jul, the central bank justified its current policy stance by pointing to the lack of broad-based economic growth despite expectations of stronger inflation in 2H 2017. It also appears to be reluctant to cut rate as called for by the IMF given concerns over highly leveraged households. That said, our economic team no longer expects the central bank to hike its benchmark policy rate in 2017 given benign inflation so far. Instead, the team expects any rate hike to come only in 2018 with growth strengthening even further and inflation picks up.

- Most recently, the BoT has been concerned about the strength of the THB given the recent weakness in the USD. The central bank has warned the private sector to hedge their foreign currency exposure to prepare for high volatility in the global money market. This warning comes in the wake of the steps taken by the BoT in Apr to reduce the supply of 3-months and 6-months bond supply in May to curb inflows and rule relaxations on 5 Jun that included: (1) granting FX licenses to brokerages to buy/sell foreign exchange for locals and foreigners; (2) bank lending to non-resident investing in Thailand no longer require central bank approval; (3) money changers can buy/sell foreign exchange with foreign banks and other money changers; and (4) individuals with assets of THB50-100mn can invest in securities abroad directly with limit of USD1m a year.

- **Latest Fiscal and External Balance Outlook:** The outstanding public debt climbed by THB79.9bn to THB6.35tn or 42.9% of GDP in May from Apr. Of this debt, 85.6% is long term and the remainder short term. According to the Public Debt Management Office (PDMO), the outstanding public debt includes THB4.9tn of government debt; THB0.97tn of SOE debt; THB0.45tn in government-guaranteed financial SOE debt; and THB17.5bn in government agency debt. In another development, the PDMO plans to swap USD250mn of USD-denominated debt into THB debt over the next one-two months given the strengthening THB. At the same time, the PDMO is mulling closing positions of JPY-denominated debt worth JPY30-40bn.

- The current account surplus continued to narrow for the third consecutive month, moderating to USD1.13bn in May from THB2.91bn in Apr. This was largely due to the deficit of USD1.10bn in the primary and secondary income account (Apr: +USD1.46bn) that offset the larger trade balance (May: +USD2.23bn vs. Apr: USD1.45bn). Despite the surplus in the current account, the overall balance of payments (BoP) slipped into a deficit for only the second time this year at USD1.63bn in May (Apr: +1.66bn), possibly due to a deficit in the 'others' segment of the financial account.

- **Key domestic events and issues to watch:** The BoT meets on 16 Aug to decide on monetary policy. The 2Q17 GDP will be released on 21 Aug.

- **Technical Outlook:** USDTHB traded softer; last seen at 33.30 levels. Underlying momentum remains bearish but risk of retracement in the short term. Bearish momentum on daily chart shows tentative signs of waning while stochastics is showing signs of turning higher from oversold conditions. Retracement could re-visit 33.60 (23.6% fibo retracement of May high to Jul low), 33.80 (38.2% fibo). Support on the downside at 32.30.

INR: RBI To Cut

Forecast	3Q 2017	4Q 2017	1Q 2018	2Q 2018
USDINR	65.20 (65.70)	65.40 (66.20)	64.90 (66.50)	65.30 (66.70)

Previous Forecast in Parenthesis

- **Motivation for the FX View:** Market players are poised for a rate cut on 2 Aug after another downside surprise in inflation prints coupled with softer industrial production figures. In the last central bank meeting, there was already one dissenter on the MPC that urged for a 50bps rate cut, more than the current market consensus of 25bps. Given the apparent reluctance in the rest of MPC members to move interest rate for fear of increasing price pressures and Governor Patel's preference to prioritize resolving the stressed assets of banks and recapitalization of PSBs, it is more likely for RBI to unleash a milder 25bps rate cut to reduce real funding costs for manufacturers and to lend support to growth and investment and unleashing more bullets if needed after they make more progress on NPLs. Insofar, RBI have raised the provisioning requirements for bad debt provisioning, that could continue to affect credit pace and growth in the near-term.

- Investors and foreign MNCs remain positive on GST even as FMCG (fast moving consumer goods) companies reportedly (by Economic Times) see some impact on the GST rollout that could weigh on their performance in the near-term. Companies noted delays in orders, destocking ahead of the GST rollout. There were even supply disruptions in the rural areas due to systems not being GST complaint. However, for the rest of the year, these firms are hopeful that sales will see a strong rebound. Inflation pressure is likely limited as price cuts were seen right after the tax overhaul rollout. Consumer benefits are also protected by a newly formed GST Anti-Profiteering Authority, an agency to ensure that the reduction in tax on supply of goods or services is fully passed to the consumers. That could pave the way for RBI to deliver more cuts.

- **Our Maybank vulnerability score** (using 9 economic and market variables: GDP, Yield, Politics, Current Account, Inflation, Fiscal, Equity Valuation, Population, Reserves) for India improved to 4.4 (with 1 being the best score and 9 being the worst) from previous 4.6 due to a stronger score for inflation relative to peers.

- **Growth and Inflation Outlook:** Key focus in the month was inflation or rather, the lack of it. Inflation slipped to just 1.6%y/y for Jun from previous 2.2%, weighed by the decline in food inflation and softening of price pressures across the board including sub components like fuel, housing and clothing. The food supply glut from the rabi harvest has depressed prices and this trend could continue given the monsoon progress so far in the past few weeks that could generate a strong kharif harvest.

- In addition, the soft inflation prints were accompanied by soft industrial production numbers. IPI fell to 1.7%y/y in May from 2.8% in the month prior. Industrial production has not been able to pick up since its sharp decline from its 2016 high of 8.9% due to a lack of private investment. Tellingly, the breakdown of the latest print also revealed a lack of business spending with growth of capital goods production now down -3.4%y/y, intermediate goods at 0.7%, infrastructure and construction at 0.1%.

- Trade growth continued to soften into Jun with exports growth weakening to 4.4%y/y from previous 8.3%. Imports growth also saw significant slowdown from 33.1%y/y to 19.0%. Still, the trade deficit narrowed to U$12.96bn from previous U$13.8bn. That should keep India's balance of payment in surplus.

- **Monetary Policy Forecast:** We see risks of a 25bps rate cut on 2 Aug (Wed). This is after a series of soft inflation prints, the onset of a normal monsoon rainfall that could boost the kharif harvest and keep food inflation tempered, soft oil gains that are unlikely to threaten fuel price pressures and a GST roll out that has been rather carefully managed along with the set-up of GST Anti-profiteering Authority that ensures that the consumers get the benefits from lower tax.

- Minutes of the Jun meeting revealed wide acknowledgements that inflation has come off due to strong rabi harvest that resulted in a food supply glut. While brent has risen from its recent lows, anticipate that inflation prints are still likely to remain subdued for a while before ticking higher. From the minutes of the Jun meeting, members of the RBI MPC committee have been watchful of upside risks to inflation stemming from rising rural wage growth, concomitant consumption demand, fiscal slippages and a possible disbursement of allowances under the 7th central pay commission's award. One member, Dr. Ravindra H. Dholakia had dissented from the rate-hold decision, recommending a 50bps cut to the policy rate to 5.75%. Recall that RBI Patel also desires a lower policy rate as he flagged that there is still room for banks to cut lending rates at the Apr meeting. With private investment persistently sluggish, inflation seemingly non-threatening and the recent imposition of more bad debt provisioning that could crimp on short-term growth and lending, We look for RBI to lower policy rate by a modest 25bps on 2 Aug and possibly a pause in the Oct meeting for more progress to resolve NPLs and recapitalize lenders.

- **Latest Fiscal and External Balance Outlook:** The Union Budget is pro-rural. Finance Minister Jaitley pledged support to the farmers, infrastructure spending and personal income tax cuts and corporate tax cuts for small and medium businesses to boost consumption and investment. Investors will closely watch for the implementation of the GST, scheduled on 1 Jul. As stated above, our equity strategists estimate a 100-150bps boost to growth from the implementation.
- The current account deficit narrowed to $3.4bn in the quarter ending Mar 2017. Financial account actually recorded a net inflow of U$5bn of direct investment and U$10.8bn of portfolio investment. That resulted a net U$12bn of balance of payment surplus, lending significant support to the rupee. That is just for the first quarter of the year. Expect financial account to show strong inflows of portfolio inflows for the quarter ending Jun that has propped up the rupee so far. Low price pressure, soft activity numbers and sanguine medium term prospect of the economy after the successful roll-out of the GST and India's resolution to reduce non-performing assets of PSBs has seen eager take up of the domestic bonds. INR could remain the favoured currency for the rest of the year.
- **Key domestic events and issues to watch:** PMI is due on the 1^{st} Aug, **RBI meeting on 2^{nd}**, trade on $10\text{-}16^{th}$, IP on 11^{th}, CPI and WPI on the **14^{th}, 2Q GDP on 31^{st}.**
- **Technical Outlook:** The USDINR 1M NDF has been biased to the downside, weighed by USD weakness, equity and bond inflows. Daily and weekly technical indicators are not showing much bias but monthly is still increasingly bearish. We eye further downside towards next support around 63.80 before 63.50 (Jul 2015 low). August is a seasonally bullish month for USDINR. So we caution against going aggressively short into the next month.

VND: FDI Remains Supportive

Forecast	3Q 2017	4Q 2017	1Q 2018	2Q 2018
USDVND	22760 (22850)	22800 (22950)	22730 (23100)	22780 (23300)

Previous Forecast in Parenthesis

- **Motivation for the FX View:** On 10^{th} Jul, SBV reduced the annual refinancing rate by 25bps to 6.25%, rediscount rate from 4.5% to 4.25% and overnight electronic interbank rate and rate of loans to offset capital shortage in clearance between the SBV and credit institutions (from 7.5% to 7.25%). The rate cut came after CPI fell by 2.54%y/y in Jun from previous 3.19%. The absence of USD strength was able to cap inflation and allowing more room for the central bank to boost credit growth at home. SBV had said that the cut was meant to "support business and economic growth". USDVND edged up in response to the cut but the move was short-lived as the pair soon settled back within the 22700-22770 range for the rest of the month. Not long after, the World Bank also upgraded its 2018 growth forecast for Vietnam to 6.4%. Portfolio inflows have risen from its dip in May and Vietnam recorded a higher amount of USD100.89mn of equity inflows for Jul so far (mtd 28 Jul) vs. USD93.1mn in Jun.

- The growth of FDI inflows for Jul remained strong at 48.7%y/y. The Ministry of Planning and Investment reported that actual FDI is estimated to have risen 6.5%y/y for the first half of the year and nearly half is attracted to the manufacturing and processing industries. Japan's U$2.8bn thermal power plant in Thanh Hoa is in particular focus as an alternative to coal-fired and hydropowers plants. Strong foreign investment interest could continue to generate income for Vietnam as well as provide some cushion for the VND from external depreciation pressures. We still see mild upside risks to the USD, especially against the USDAsians, though our levels are calibrated lower to take into account the recent downdrift in the USD. The bids in USDVND in a stronger USD environment could be aggressive and we see it as a matter of when, not if. An upside trajectory is expected to lift the USDVND towards 22800 by year end.

- **Growth and Inflation Outlook:** July started off rather promising with PMI-mfg at 52.5 vs. previous 51.6. The manufacturing scene saw a strong increase in new orders, rise in output, employment and purchasing activities. However, the actual industrial production failed to follow through, released at a slower pace of 8.1%y/y vs. the previous 8.6%, dragged by slower production from the manufacturing sector. Looking at the flow of FDI into the manufacturing sector, pace of registered FDI growth rose 11.8%y/y, slowing from 30% in Jun. That said, total FDI growth was still a rather solid pace of 48.7%y/y for Jul. With VND likely less threatened by the USD, stable CNY also providing an anchor for the currency, price pressures also concomitantly capped and allowing SBV to ease interest rates, Vietnam may continue to attract foreign investors for its infrastructure development. In the meantime, Vietnam has been seeing double digit growth in visitor arrivals, although at a slower pace of 22.5%y/y in Jul vs. the previous 35.5%. Trade numbers are still in high double digit growth for both exports and imports even as trade deficit widened a tad to U$300mn from previous U$200mn. Retail sales softened marginally to 10.0%y/y from previous 10.1%.

- Inflation softened towards 2.52%y/y for Jul from 2.54% in the month prior as food inflation remained on the decline. Subcomponents like housing and construction and transportation also saw a deceleration in CPI. With energy prices unlikely to register strong gains, USD less threatening before and concomitant less depreciation pressure on the VND, price pressure may remain capped for the rest of the year.

- PM Nguyen Xuan Phuc had said he is confident economic growth this year will meet the target of 6.7% without threatening the inflation target of 4%. Indeed, the fall in inflation prints have allowed SBV to cut policy rates to boost credit growth towards the 18% targeted for the year. Strong growth in exports, foreign investment and agriculture production should also strengthen income growth for 3Q and 4Q.

- **Monetary Policy Forecast:** With effect from 10th Jul, SBV cut its official policy rates. reduced the annual refinancing rate by 25bps to 6.25%, rediscount rate from 4.5% to 4.25% and overnight electronic interbank rate and rate of loans to offset capital shortage in clearance between the SBV and credit institutions (from 7.5% to 7.25%). The rate cut came after CPI fell 2.54%y/y in Jun. The absence of USD strength was able to cap inflation and allowing more room for the central bank to boost credit growth at home. SBV had said that the cut was meant to "support business and economic growth". We also recall that the National Assembly passed a resolution on 21 Jun that allows bad debt to be bought and transferred with special bonds into bad debt at market prices under the guidance of the SBV. This move might be also one that could ease up credit conditions so that the resolution on NPL could be more easily executed. In the meantime, the cut in policy rates have triggered commercial banks to lower its deposit rates to retain their Net Interest Margin (NIMs). With USD remaining on a sluggish trend, USDVND could remain at the current range and that could actually be conducive for foreign investment. As of May 25, total loans rose 6.5% from end-2016. Credit growth is targeted at 18% this year.

- **Latest Fiscal and External Balance Outlook:** Little development on this front though the Finance Minister Dinh Tien Dung assured that the government continues to aim for balanced budget in the long run. The state budget collection met 46.5% of the annual target this year. Domestic collection is expected to make up 84-85% of state budge income while 14-16% should arrive from crude oil export and other import-export activities (Vietnamnet).

- Vietnam set a lower budget deficit of 3.38% of GDP for 2017 from previously 3.50%. 2016-18 public debt (including government debt, debt guaranteed by government, municipal debt) is capped at 65% of GDP. 2016-18 government debt is set at no more than 54% of GDP while foreign debt is set at no more than 50% of GDP.

- The government has an ongoing effort to divest VND67trn from SOE in the years leading to 2020. Key use of the capital is to develop important infrastructure projects like the Long Thanh International airport, along with the recent plans to build the Chrey Thom Bridge that will connect the southern province of An Giang in Vietnam to Cambodia's Kandal province. This is meant to promote bilateral trade and bring about more economic benefits for those communities along the border areas though a time frame was lacking.

- Current account recorded a deficit of U$1.169bn in 1Q (latest data available), just as we have expected, deteriorating from the surplus of U$155mn seen in 2016 4Q on the back of net U$26mn trade deficit of goods and net U$600mn trade deficit of services in addition to the net primary income payment of U$2.38bn. That said, the financial account recorded a net inflow of U$3.745bn. External trade balance continues to record deficit for 2Q though that could be partially offset by a more positive portfolio inflow seen for the quarter. Current account may continue to record a deficit in this quarter.

- **Key Domestic Events and Issues to Watch:** PMI-mfg is due on 1st Aug. Jul CPI is due on the 24th. Jul trade balance, industrial production and retail sales within 25-31st.
- **Technical Outlook:** USDVND hovered within 22650-22770 for much of Jul, save for a brief attempt at the upper bound on 13 Jul that was quickly reversed out. Last seen around 22735, the weekly chart indicates waning bearish momentum and stochs are also rising. We see mild upside risk with key resistance level seen around 22760 that could bring the pair towards the year high of 22850. Support is seen around 22650 (61.8% Fibonacci retracement of the Oct – Mar rally).

FX Forecasts

	End Q3-17	End Q4-17	End Q1-18	End Q2-18
USD/JPY	112	115	115	117
EUR/USD	1.1600	1.1700	1.1800	1.1600
GBP/USD	1.3150	1.3000	1.2900	1.3200
AUD/USD	0.8000	0.8100	0.7800	0.7900
NZD/USD	0.7300	0.7500	0.7700	0.7600
USD/SGD	1.3500	1.3500	1.3600	1.3650
USD/MYR	4.2500	4.2750	4.3000	4.2500
USD/IDR	13350	13400	13450	13450
USD/THB	33.50	34.00	34.00	34.30
USD/PHP	50.80	50.90	50.90	50.70
USD/CNY	6.77	6.80	6.81	6.83
USD/HKD	7.80	7.80	7.80	7.80
USD/TWD	30.80	31.00	31.50	31.00
USD/KRW	1150	1160	1170	1180
USD/INR	65.20	65.40	64.90	65.30
USD/VND	22760	22800	22730	22780
DXY Index	94.89	94.96	94.33	95.20
SGD Crosses	End Q3-17	End Q4-17	End Q1-18	End Q2-18
100 JPY/SGD	1.2054	1.1739	1.1826	1.1667
EUR/SGD	1.5660	1.5795	1.6048	1.5834
GBP/SGD	1.7753	1.7550	1.7544	1.8018
AUD/SGD	1.0800	1.0935	1.0608	1.0784
NZD/SGD	0.9855	1.0125	1.0472	1.0374
SGD/MYR	3.1481	3.1667	3.1618	3.1136
SGD/IDR	9889	9926	9890	9853
SGD/THB	24.81	25.19	25.00	25.13
SGD/PHP	37.63	37.70	37.43	37.14
SGD/CNY	5.01	5.04	5.01	5.00
SGD/HKD	5.78	5.78	5.74	5.71
SGD/TWD	22.81	22.96	23.16	22.71
SGD/KRW	852	859	860	864
SGD/INR	48.30	48.44	47.72	47.84
MYR Crosses	End Q3-17	End Q4-17	End Q1-18	End Q2-18
EUR/MYR	4.93	5.00	5.07	4.93
JPY/MYR	3.79	3.72	3.74	3.63
MYR/HKD	1.84	1.82	1.81	1.84
MYR/CNY	1.59	1.59	1.58	1.61
GBP/MYR	5.59	5.56	5.55	5.61
AUD/MYR	3.40	3.46	3.35	3.36
NZD/MYR	3.10	3.21	3.31	3.23
MYR/IDR	3141.18	3134.50	3127.91	3164.71
MYR/INR	15.34	15.30	15.09	15.36
MYR/KRW	270.59	271.35	272.09	277.65
MYR/PHP	11.95	11.91	11.84	11.93
CNY/MYR	0.6278	0.6287	0.6314	0.6223

Source: Maybank FX Research as of 31 Jul 2017

*These forecasts are meant to be indicative of FX trends and not meant to be point forecasts.

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